



DEM. CANDIDATES
WOULD RAISE FEDERAL
BUDGET DEFICIT 3

COOK COUNTY
BURNED BY TAX
INCREASE 9

TEL LESSONS 4

Budget & Tax News

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THE MONTHLY NEWSPAPER FOR TAX ISSUES

V2 N3 ~ MARCH 2004

Oregon Voters Soundly Reject Tax Hike

“Don’t even think about raising taxes,” say 60 percent of voters

by Jonathan Collegio

Although most press attention focused on the seven Presidential primary elections taking place on February 3, the biggest political win on that date did not belong to John Kerry.

“The biggest victory belongs to Oregon taxpayers, who defeated a massive \$800 million tax hike at the ballot box

by 60 to 40 percent,” said Sandra Fabry, spokesperson for Americans for Tax Reform, in a February 4 news release. “Their message to Gov. Ted Kulongoski (D) and the state legislature: Don’t even think about raising taxes.”

In August 2003, the state legislature passed a massive tax increase, HB 2151, without public hearings and little debate. Voters nevertheless had the final

say, when Measure 30 was rejected on February 3. Voting “no” told the Oregon legislature to cut spending rather than hike taxes.

The referendum process, adopted in Oregon in 1902, allows citizens to take any specific item of legislation passed during the legislative session and place it on a ballot for Oregon voters to make the ultimate decision. Measure 30 was a vote to overturn part of the \$1.1 billion in tax hikes included in HB 2151.

“I couldn’t be happier about the results,” stated Russ Walker, director of Oregon Citizens for a Sound Economy and chief petitioner for Measure 30. “When we set out to put Measure 30 on the ballot five months ago, we

OREGON p. 5

GA Gov. Touts Spending Restraint, No New Taxes



Gov. Sonny Perdue

by John Skorburg

Before a joint session of the Georgia legislature on January 13, Gov. Sonny Perdue (R) outlined his vision for the state of Georgia during the annual State of the State address in Atlanta.

“Across all lines of race, religion, and economic status, Georgians believe that our children are the most precious resource we have,” said Perdue. “They are also united in wanting good jobs, a growing economy, and lasting prosperity.”

The governor and General Assembly

GEORGIA p. 8

108th Congress to Address State Taxes

by Chris Atkins

According to the American Legislative Exchange Council (ALEC), at least four “critical state tax issues” will be debated this year in Congress.

Facing the worst fiscal crisis since World War II, state governments have looked high and low for solutions to erase budget deficits. States have bonded tobacco settlement funds, accelerated tax collections, delayed payments, raided special funds, and in some cases

AGENDA p. 14

Bush Pushes for Permanent Tax Cuts



by William W. Beach

In his January 20 State of the Union address, President George W. Bush called on Congress to make permanent the tax reductions passed since he took office. The President remains confident his economic policies—tax cuts totaling some \$1.7 trillion over 10 years—are boosting the economy and assuring its long-term growth.

“The American economy is growing stronger,” Bush declared to applause. “The tax relief you passed is working. The temporary tax cuts should be made permanent.” Bush had good reason for calling on Congress to act this year.

Within the next two years, key provisions of the 2001 Economic Growth and Recovery Tax Act will expire. Nearly all elements of the act disappear in 2011. As the President noted, the steady expiration of this landmark tax act will:

- reduce the child tax credit by \$300;
- revive many of the worst “marriage penalties” in the old tax code;

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President George W. Bush used his January State of the Union address to urge Congress to make permanent the temporary tax cuts passed since he took office.

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TAXES

IRS Error Rate Still High

by Daniel J. Pilla

The January 2004 report of the Treasury Inspector General for Tax Administration [TIGTA] confirms the IRS's error rate for advice it gives at its hundreds of walk-in Taxpayer Assistance Centers (TACs) remains unacceptably high.

The report reveals the IRS provided "flatly incorrect answers 20 percent of the time." In another 15 percent of the cases, the IRS provided a "correct" answer without first obtaining the background information necessary to provide a correct answer—a serious oversight when providing tax advice.

Know Your Facts and Rules?

A father might ask, for example, whether it's legal to claim his child as a dependent on his tax return. One might simply answer yes and be correct, but only in a very broad sense. Without knowing all the facts about that child, it is very possible the correct answer for that particular father is no. For example, in a situation where the parents are divorced and legal custody of the child rests with the mother, it is not allowable for the father to claim the child as a dependent unless the mother signs a written waiver granting the exemption to the father.

The problem here is that most citizens just don't know all the rules. Consequently, citizens don't know what information to provide to the IRS as background for their question, and they have no way to ascertain whether the IRS asked sufficient questions to obtain the necessary facts.

When this kind of incomplete advice is factored in, the total inaccuracy rate rises to a troubling 35 percent.

Do Your Own Research?

One equally troubling aspect of the report indicates that in about 3 percent of the cases, IRS employees essentially told Treasury investigators to "do their own research." Rather than helping to find the correct answer to the question, the IRS simply referred investigators to publications to find the answers for themselves. Considering the often convoluted and technical nature of IRS publications, this is not only unreasonable ... it's a violation of the directives under which TAC employees are supposed to operate. Their job, after all, is to answer the questions posed by confused taxpayers, not send them off on a quest for answers potentially buried in thousands of pages of publications.

It is important to note the questions asked by Treasury investigators were not esoteric tax law inquiries. All the questions pointed at narrow, relatively simple areas of law that TAC employees are trained in and expected to know.



"[A]t a time when TAC employees cannot provide error-free answers to questions in areas they are trained in, they are taking stabs at answering questions in areas they are not trained in."

Given this, it is reasonable to expect and demand that TAC employees get it right—period. TAC employees are not being trained adequately.

This brings up another disturbing aspect of the investigation. When TAC employees are asked a question that is outside the scope of their training, they are required by operating guidelines to refer the questions to other, more qualified, IRS personnel. However, in 31 percent of the cases, TAC employees answered questions outside the scope of their training, in violation of the regulations. So at a time when TAC employees cannot provide error-free answers to questions in areas they are trained in, they are taking stabs at answering questions in areas they are not trained in. We can only guess what the error rate is for those answers.

Will the Problem Get Worse?

The National Taxpayer Advocate's (NTA) 2003 Annual Report to Congress,

released in January 2004, suggests we can expect this problem to get worse. The Taxpayer Advocate reports the IRS is "reducing the resources dedicated to providing taxpayer assistance, while at the same time, beefing up its enforcement arsenal." The result, according to the NTA, is "a declining trend in providing services" to those in need and an "increase in taxpayer burden."

Why can't the IRS get it right, even in relatively simple areas of the law? The answer is provided by former Commissioner Charles O. Rossotti, in a statement addressing the reason for the error rate in the IRS's telephone assistance function.

Said Rossotti, "Fundamentally, we are attempting the impossible. We are expecting employees and our managers to be trained in areas that are far too broad to ever succeed, and our manuals and training courses are, therefore, unmanageable in scope and complexity."

Daniel J. Pilla is a nationally known tax litigation specialist and executive director of the Tax Freedom Institute. He has written eleven books on taxpayers' rights issues and IRS defense strategies.

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Presidential Candidates Would Raise Federal Budget Deficit

by Pete Sepp

If any of the Democratic Presidential candidates ultimately has his way, the federal budget deficit will grow dramatically, according to a study released January 19 by the National Taxpayers Union Foundation (NTUF).

"Long on rhetoric, short on restraint," concluded NTUF analysts after reviewing each candidate's fiscal policy agenda.

"Despite expressing concern over red ink in the federal budget, every one of the eight hopefuls would worsen the deficit by billions or even trillions of dollars," noted NTUF President John Berthoud. "The Democratic candidates for President have bashed President Bush's tax cuts as 'fiscally irresponsible.' A fair reading of their agendas, however, indicates that the only reason they don't like the tax cuts is that they want the money in Washington to spend even more."

"The eight [Democratic Presidential] candidates have proposed more than 200 ideas to increase federal spending, and only two that would cut federal spending."

According to the President's Office of Management and Budget (OMB), the FY2003 deficit was \$375 billion, or 4.2 percent of Gross Domestic Product (GDP). The OMB's Web site reports, "As a percentage of GDP, the budget deficit is expected to be cut by more than half by 2006," from 4.2 percent in both FY2003 and FY2004 to 1.9 percent by FY2006.

This is in contrast to a FY2000 budget surplus of \$236 billion. According to the OMB, "The growth rate of non-defense spending has fallen dramatically since the September 11, 2001 terrorist attacks, while defense and homeland security spending recorded sharp increases."

Berthoud and NTU policy analysts disagree with that statement. "Although there are many statistical interpretations of domestic federal spending, NTU certainly does not subscribe to the notion that non-defense spending has 'fallen dramatically,'" said Berthoud. "In any case, it is about to rise dramatically as the Medicare prescription drug bill is phased in."

"While the spending record of President Bush has been very disappointing, his challengers seem only to want to spend even more. This is bad news for future generations who will have to foot the bill for all this government largesse," noted Berthoud.

"All the Presidential challengers have to varying degrees disparaged the current size of federal deficits," said study

author and NTUF Policy Analyst Drew Johnson. "Yet, our examination of the candidates' spending promises reveals an inconvenient fact: The deficit pot-holes they're complaining about on the road to the White House would only deepen under their own policies."

The NTUF study systematically examined the fiscal policy implications of the eight contenders' agendas, using campaign and third-party sources (like the Congressional Budget Office) to assign a cost to each budget proposal offered by the candidates. For legislation the candidates have endorsed, the study also relies on NTUF's BillTally project, a computerized accounting system that has, since 1991, tabulated the cost or savings of every piece of legislation introduced in Congress with a net annual impact of \$1 million or more. The study included an analysis of proposals offered by Howard Dean, Dick Gephardt, Joseph Lieberman, and Wesley Clark, although they have since dropped out of the race.

According to the NTUF study,

■ If the policy agenda of any one of the eight candidates were enacted in full, annual federal spending would rise by at least \$169.6 billion (Joseph Lieberman) and as much as \$1.33 trillion (Al Sharpton)—a yearly budget hike of between 7.6 percent and 59.5 percent.

■ All candidates offer platforms that call for more spending than would be offset by repealing the Bush tax cuts (using even generous estimates of the tax cuts' impact).

■ The eight candidates have proposed more than 200 ideas to increase federal spending, and only two that would cut federal spending. Those two proposals have been offered by Dennis Kucinich—the other seven have not made a single proposal to cut spending.

Johnson noted the study does not even take into account that the "temptation to spend more money" can increase after entering the White House. George W. Bush, for example, who campaigned as a fiscal conservative in 2000, has presided over a jump in federal spending of 23.7 percent since taking office. According to Johnson, even the most parsimonious of the Democratic Presidential candidates would have outpaced the spending run-up under Bush by 15 percent.

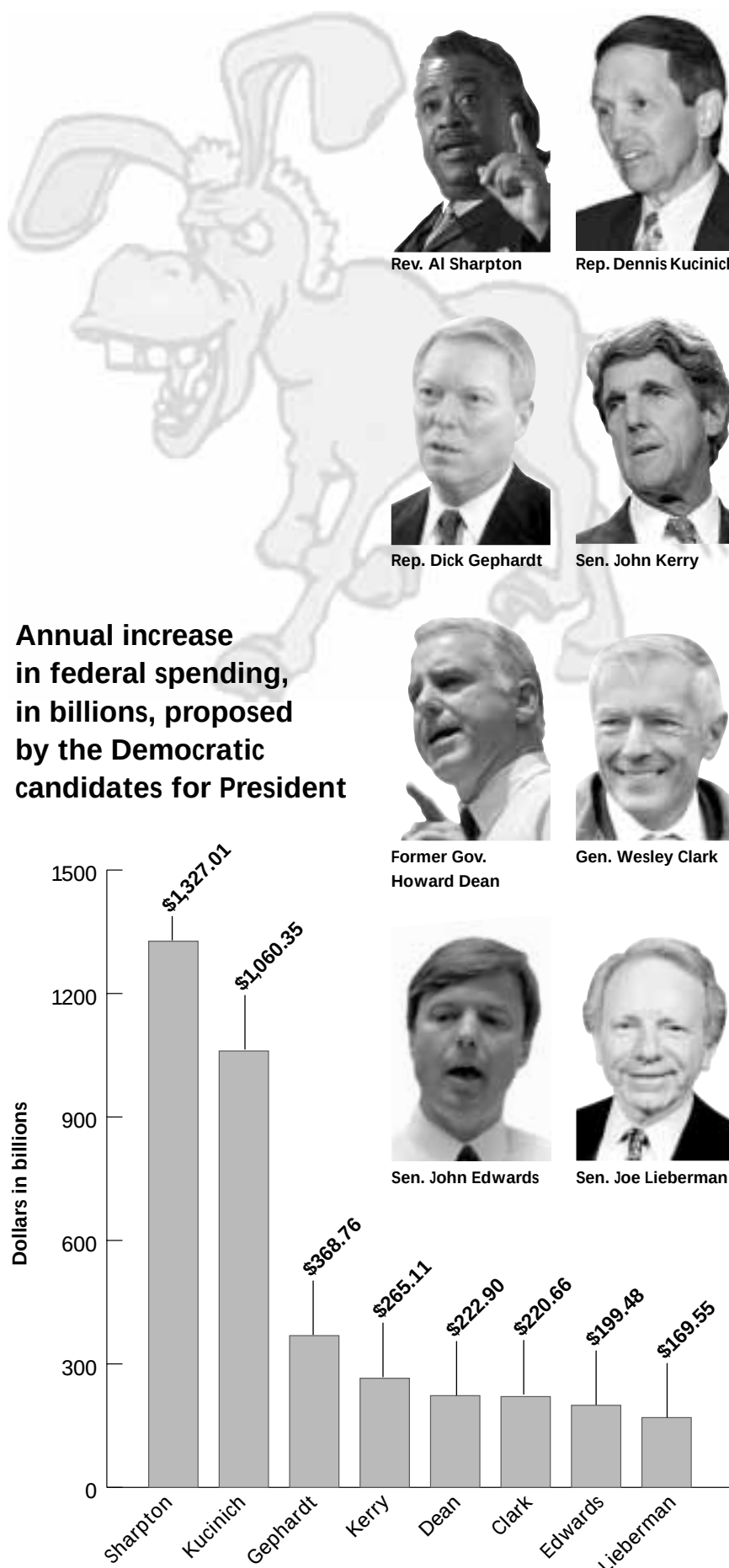
"During the 2000 Presidential election, the candidates traded charges of 'fuzzy math' and 'risky schemes' over each other's fiscal policy proposals," Johnson concluded. "Given the results of this study, many deficit-conscious Americans may be wondering if such terms are applicable to the 2004 race too."

Peter Sepp is vice president for communications at the National Taxpayers Union Foundation. His email address is pressguy@ntu.org.

INTERNET INFO

Drew Johnson's *Policy Paper 148*, "The Return of Fuzzy Math and Risky Schemes: How Presidential Hopefuls Would Deepen Deficits," is available on the National Taxpayers Union Foundation Web site at <http://www.ntu.org>. Also available are detailed reports on the cost of each candidate's platform proposals.

Go Figure





Lessons from 30 Years of TEL Experience

by Lew Uhler and Barry Poulson

The first tax and expenditure limitation (TEL) was proposed by California Gov. Ronald Reagan in 1972. In the years since then, numerous states have adopted TELs. By studying these laws, we have discovered principles and design concepts for effective tax limitation.

State TELS

In spring 1978, under the leadership of State Rep. David Copeland, the people of Tennessee adopted the first constitutional tax limitation measure in the nation, the work product of a state constitutional convention.

Then came Proposition 13 in California in June 1978. While not itself a TEL (it was primarily a limitation on the growth of property taxes), Prop. 13 was the catalyst that ignited a national tax revolt. Things began to happen quickly across the country:

- Arizona, under the leadership of then-Senate Majority Leader Sandra Day O'Connor, adopted a TEL referendum in 1978.

- In November 1978, Michigan adopted the Headlee Amendment, which restricted state spending as a share of personal income.

- In 1979, California adopted a Prop. 1-type TEL (the Gann Limit) that for the first time limited the growth of state spending by measuring it against inflation and population or per-capita personal income growth, instead of a percentage of state personal income growth, which really tightened the year-over-year control over taxes and government spending.

- Also in 1979, Washington State adopted a TEL (Initiative 62).

- In 1980, Missouri adopted the Hancock Amendment, again using a percentage of state personal income growth as the measure.

- In 1980, Massachusetts's Prop. 2 drew heavily on the language of California's Prop. 1 in order to control the growth of local governments.

Lessons Learned

Many other states have since adopted constitutional or statutory controls. But many were not tough enough or sufficiently well enforced or honored

to be effective.

Circumvention began in earnest in Missouri as the legislature and courts played games with the revenue base and school financing. In California in 1989, wily Assembly Speaker Willie Brown corrupted the Gann Limit formula in a statewide initiative devoted to improving California's roads and highways.

It is clear that constitutional (not statutory) TELs initiated by the people (in those states that permit referenda and initiatives) are the strongest and most resistant to circumvention. Furthermore, limiting year-over-year growth in spending to population and inflation changes, as well as imposing limits on both state and local governments, provides the greatest safeguards for the taxpayers.

From these lessons the TEL design was improved, culminating in the best models in Colorado (1992) and Washington State (1993). While the Washington initiative has been circumvented by subsequent action of the state legislature (Washington law permits only statutory initiatives, which remain immune from legislative changes for only two years), Colorado's "Taxpayers Bill of Rights" (TABOR) has been very successful. Colorado's economy has boomed while tax cuts and surplus rebates have become the order of the day.

Principles and Design Concepts

Summarizing 30 years of tax limitation experience isn't easy, but we offer the following principles and design concepts:

- While laws control men, only constitutions control governments. Fiscal discipline imposed not *by* those we elect, but *upon* them, is the only safe route. A TEL is an important element of people power: It reinforces the basic notion that all power derives from the people, the consent of the governed. A TEL, to be truly effective, must be embodied in a state's constitution. Those states with the initiative/referendum process have the best chance for a good TEL.

- Voting rules make a difference. Super-majority votes of the legisla-

ture for tax increases and emergency appropriations are key disciplines. Votes by the people to increase taxes, fees, and debt, and to allow the government to spend more than the limit would otherwise allow, are essential to the integrity of a TEL. Efforts to circumvent established votes of the people for general obligation bonds or other debt instruments must be prevented.

- The definitions of the TEL limits are crucial. Linking the TEL limit to personal income growth, or even a portion of that growth, is too generous. A TEL limit based on the growth of population plus inflation is a more stringent constraint on the growth of revenue and expenditures. The TEL must apply to local as well as state governments. Otherwise, constraint at the state level can be circumvented by shifting functions to local governments. No government function, such as education, should be permitted to remain outside the TEL, and there should be no earmarking of a specific revenue source for a designated government function.

- Tax reductions should occur as quickly as possible. To the extent possible, taxes should be cut in advance of the generation of a surplus to reduce extraction costs and leave productive resources in the hands of those who produced them. Actual surplus revenues above the TEL limit should be rebated as quickly as possible so they do not tempt legislators to creatively circumvent the limit and spend the surplus.

- Allow limits to be suspended in bad economic times. The revenue/spending limit should be suspended during bad economic times when tax revenues actually decline year-over-year. In that event, the prior year's revenue/spending limit remains "frozen" into the future until, once again, revenues increase beyond the revenue/spending limit.

- Create multiple funds for surplus revenues. There should not be a single reserve or rainy-day fund. Multiple funds for different purposes with different operational rules should be established. A portion of the surplus revenue above the TEL limit should be allocated to a budget stabilization fund

(BSF). The share of surplus revenue allocated to the BSF and that allocated to tax rebates should be defined, and a cap placed on the BSF. All surplus revenue above that cap should be offset by tax cuts or tax rebates.

The BSF should be used during economic downturns when revenues actually decline year-over-year (except when such decline is the result of an explicit tax elimination or rate reduction). The transfer of funds from the BSF to the general fund should occur automatically on a quarterly basis and in a specified amount when the director of the state department of finance (or similarly situated officer) determines that revenues in a particular quarter have declined from the revenue level of the same quarter in the preceding year. Neither the legislature nor the governor should have any role in this determination of transfers.

- Create an emergency fund. An emergency fund (EF) should be established representing approximately 3 percent of general fund revenues, preferably funded out of revenues within the limit in preceding years. Appropriations may be made from this fund for natural or other non-economic disasters upon declaration of an emergency by the governor and a super-majority vote of the legislature. The EF should be refunded in the year following such appropriations.

- Adopt a rule on which taxes to cut. When tax cuts are made to reduce future surpluses, the cuts should be made in taxes in reasonable proportion to their contribution to that surplus. Cuts that reduce or eliminate tax system progressivity are to be given preference as they will preclude excessive future surpluses.

Tax and expenditure limits now have a rich history. If we fail to heed the lessons of history, we are doomed to repeat them. As we move forward to restore existing limits and to pass new ones, we must heed those lessons.

Lew Uhler is president of the National Tax Limitation Committee and Dr. Barry Poulson is a senior fellow with the Independence Institute and professor of economics at the University of Colorado.

Oregon

Continued from page 1

knew that Oregonians were against these tax increases.”

“Raising taxes during a recession is simply bad economics. Oregon’s families will now be able to spend or invest that money in the best way possible for their quality of life,” said Roger King, a Medford resident and active volunteer in defeating Measure 30.

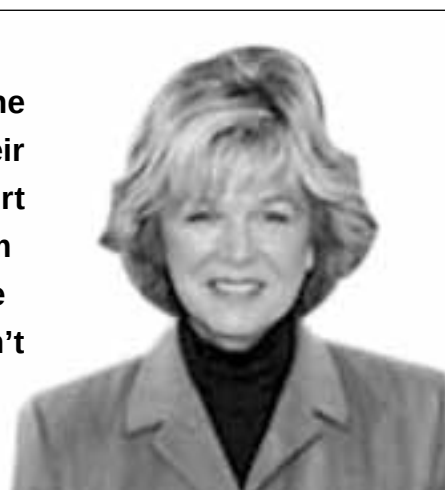
State Rep. Linda Flores (R-Clackamas County), who pushed during the 2003 legislative session for requiring state government to examine core functions and prioritize when setting budgets, was also pleased with the referendum’s results. “Now I hope we can truly dive into the discussion of putting our most essential services such as education, health care, and public safety, to the forefront of the budgeting process instead of holding them hostage in debates over tax increases.”

Flores continued, “There is a clear lack of trust among the people toward the way government spends their money. With the lack of effort on the part of many in Salem to find efficiencies and make government more lean, I can’t say that I blame them.”

“The margin of defeat is larger than expected,” said Kevin Mannix, state chairman of the Republican Party and opponent of the tax package.

“There is a clear lack of trust among the people toward the way government spends their money. With the lack of effort on the part of many in Salem to find efficiencies and make government more lean, I can’t say that I blame them.”

STATE REP. LINDA FLORES



Enough Is Enough

Rejection of the tax increase will trigger \$544 million in automatic spending cuts on May 1. The referendum vote suggests Oregon taxpayers dislike higher taxes more than spending cuts.

“Enough is enough,” said Oregon commercial fisherman Terry Hardy. “The most essential things they threaten to cut, instead of the fat. I’m so taxed out now.”

Writing in the February 4 edition of the *San Francisco Chronicle*, political analyst Jim Moore said the vote showed Oregonians “weren’t swayed” by warnings that schools and other services would suffer big cuts without the tax increase. “People are suspicious of government, and they simply weren’t buying the doom and gloom thing,” Moore wrote.

Debbie Dorris, a backer of the tax increase, said she thinks some voters

have simply “tuned out” the seemingly endless debate over the state’s budget crisis. “People are pretty fatigued over the whole issue,” Dorris said.

In January 2003, Oregon voters rejected Measure 28, a \$313 million tax increase proposal. Even after that clear expression of their constituents’ will, the legislature passed, with significant bipartisan support, a tax hike more than twice as big, increasing seven different taxes. The bill passed late in the session, the result of legislative tinkering that stripped a related bill of all its contents and inserted the tax hike language.

A National Trend

“The national trend against tax hikes is finally solidified at the state level,” said taxpayer advocate Grover Norquist, who heads Americans for Tax Reform (ATR)

in Washington, DC. “With this Congress and President Bush, tax hikes in Washington are dead before the words are even uttered. And with massive taxpayer victories in Alabama, California, and now Oregon, the national consensus against tax increases is firming up even in liberal states.”

In California, tax and budget issues led to the demise of former Gov. Gray Davis (D) and the rise of Arnold Schwarzenegger (R). In Alabama, voters defeated Republican Gov. Bob Riley’s tax hike by an overwhelming 68-32 percent vote.

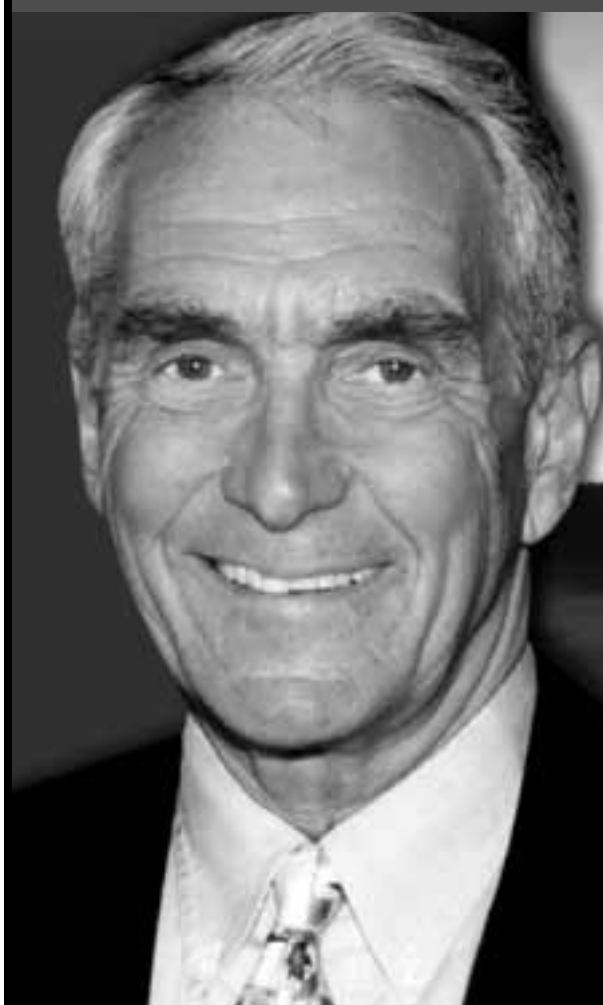
“Ninety five percent of Republicans in the U.S. House have sworn against tax increases,” continued Norquist. “Eighty-five percent of Republican Senators have, as well as President Bush. In the states, roughly 25 percent of Republicans have signed ATR’s Taxpayer Protection Pledge against tax hikes. As voters continue to tell their elected leaders to not even think about raising taxes, the ranks of taxpayer advocates in the nation’s legislatures will continue to grow.”

Jonathan Collegio is director of communications for Americans for Tax Reform. His email address is jcollegio@atr.org.

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For more information visit the Web site of Americans for Tax Reform at <http://www.atr.org>.

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Illinois Governor Proposes Takeover of Board of Education

by John Skorburg

In a January 15 State of the State address that stunned many, Illinois Gov. Rod Blagojevich (D) dropped what one senator called an "atomic bomb" on the state department of education.

"To sum it up, the Illinois State Board of Education has failed in its mission. It's a burden to the taxpayers. It's a drain on local schools. It's an albatross to our principals and teachers. It's not helping our children," Blagojevich said. "And it hasn't lived up to what the delegates at our Constitutional Convention envisioned, something far different, something far better, than what we ended up with."

The governor compared the board to an "old, Soviet-style bureaucracy" that is bloated, squanders taxpayer money, and has run amok. "It's clunky and inefficient, it issues mandates, it spends money, it dictates policy, and it isn't accountable to anyone for anything," the governor said.

"This is a bureaucratic nightmare of biblical proportions," Blagojevich quipped, noting that at more than 2,800 pages, the Board of Education's administrative rules take up more space than the King James Bible, the Torah, and the Koran combined.

The Board of Education makes policy for elementary and secondary government schools across the state. It is required by law to present the governor and General Assembly with an annual budget proposal by mid-January. On January 8, the board recommended the fiscal year 2005 elementary and secondary education budget include a \$609 million General Funds increase over the fiscal year 2004 appropriation.

The FY2004 state budget for elementary and secondary education is \$8.5 billion, up \$309 million from FY2003. Elementary and secondary education represents nearly 16.5 percent of the state's total FY2004 appropriations of \$52.4 billion.

State Takeover Proposed

Blagojevich has proposed shifting most of the Board of Education's administrative duties to a new Department of Education under his control. By doing so, he predicted, he could "trim up to \$1 billion in waste over four years—money that could be rechanneled to classrooms."

"Even the Berlin Wall eventually came down," Blagojevich said. "Allowing the State Board of Education to be a barrier to progress is like throwing money down the drain."

"I've been around several governors and the General Assembly for a long time, and I've never seen a governor lay an atomic bomb on one issue like Gov. Blagojevich did in his speech with respect to the State Board of Education," said Sen. Kirk Dillard (R-Hinsdale), who said he

backed the governor's concept but "wanted more details."

According to the *Chicago Sun-Times*, Blagojevich pledged to make the new agency work with "80 percent of the budget now in place for the state Board of Education and with 60 percent of the board's current work force," which now totals about 490 people. A shell of the existing state board would remain under the governor's plan as an education "think tank."

Dr. Michael J. Bakalis, a former Illinois State Superintendent of Schools currently on the faculty at Northwestern University's Kellogg Graduate School of Management, supports the Blagojevich proposal. "Back in 1970, I thought it was in the best interest of the state to have an independent board of education. But over the years, that independence has allowed the board to grow into a sizable bureaucracy that answers to no one," Bakalis said. "With something as critical as education—an issue that directly impacts our state's social and economic success—it's imperative that we establish a clear line of responsibility."

Spokespersons for the state's largest teacher union, the Illinois Education Association (IEA), also expressed support for Blagojevich's plan. "For too long the State Board of Education has been accountable to no one, leading to periods of chaos and confusion, so we applaud the governor's leadership," said IEA President Anne Davis.

The *Sun-Times* reported Blagojevich's proposal also has the support of the American Federation of Teachers and 15 legislators from both parties.

"Getting rid of the State Board still doesn't put power in the hands of parents and so it's largely a smoke and mirrors effort—lots of 'sound and fury, signifying nothing.'"

Support Not Universal

The legislative leadership, however, did not immediately jump on the Blagojevich bandwagon. Senate President Emil Jones (D-Chicago) said he wanted to "take a closer look at Blagojevich's proposal." He promised to work with the governor but predicted a difficult legislative fight ahead.

"All this rhetoric is great. The public will gobble it up," said Sen. Miguel del Valle (D-Chicago), chairman of the Senate Education Committee. "But what are we really accomplishing here?"

"It's pretty hard to argue with a lot of what he said, but obviously the devil is in the details," said House Republican Leader Tom Cross (R-Oswego). "Last year [former governor] George Ryan and the General Assembly were the whipping posts. This year the state board is going to be the whipping post."

Peter LaBarbera, executive director of the Illinois Family Institute,

"[T]he Illinois State Board of Education has failed in its mission. It's a burden to the taxpayers. It's a drain on local schools. It's an albatross to our principals and teachers. It's not helping our children."

GOV. ROD BLAGOJEVICH



expressed concern about the impact Blagojevich's proposal would have on school accountability.

"[T]he best hope for education improvement in Illinois lies in a competitive education marketplace—fueled by true school choice and the education freedom it brings," LaBarbera said. "The clearest pathway to making that school choice a reality in Illinois is the mounting pressure on the Illinois State Board of Education and the schools under its leadership to

meet steadily rising achievement standards set by federal law. Any reorganization that gets in the way of that process is bad for Illinois families and a hindrance to the ultimate and urgent goal of improving education across the state."

"I'm ambivalent," said Joseph Bast, president of The Heartland Institute and publisher of *Budget & Tax News*. "The good news is that notably absent from Gov. Blagojevich's 86-minute speech were discussions of reducing the gap between the state's richest and poorest schools, increasing state government's contribution to education costs, or consolidating some of the 892 school districts in Illinois. Had he sided with the tax hikers, we would have been in real trouble. This is all just rearranging chairs on the deck of the Titanic. Nobody in Springfield (or Chicago) is interested in school choice and vouchers. Until that changes, nothing will improve."

George Clowes, managing editor of

School Reform News, pointed out, "Gov. Blagojevich wants to take over responsibility for Illinois public schools because, he says, Mayor Daley took responsibility for Chicago's public schools in 1995 and it worked."

"But it didn't work," Clowes continued. "The only success Daley can claim is that the Chicago public schools are no longer the worst in the country, as William Bennett dubbed them when he was U.S. Education Secretary. They are now fifth or sixth from the bottom when compared to other major urban school districts in the recent National Assessment of Educational Progress. Is Blagojevich cheering the fact that the public schools in Chicago are a little better than those in Cleveland and Washington, DC—but worse than those in New York City and still well below the national average? Parents would offer a Bronx cheer to that claim."

Clowes ended, "I think the Governor's indictment is faulty. The thousands of rules and regulations the State Board is charged with implementing were created by the legislature, not by the State Board. Getting rid of the State Board still doesn't put power in the hands of parents and so it's largely a smoke and mirrors effort—lots of 'sound and fury, signifying nothing.' It doesn't change the fundamental power structure. It certainly won't help the children of Illinois."

The General Assembly is scheduled to adjourn at the end of May. By law, a FY2005 budget must be in place before it can do so.

John Skorburg is managing editor of *Budget & Tax News*. His email address is skorburg@heartland.org.

Oklahoma Teacher Salaries Compare Favorably to Other States

by Edwin S. Rubenstein

In May 2003 the National Education Association reported Oklahoma is "47th in the nation in public school teacher pay." According to the NEA, "Oklahoma's average teacher salary (\$34,744) is just 78 percent of the national average (\$44,683)."

Does this suggest Oklahoma lacks commitment to quality education? Many people wonder after seeing such 50-state rankings of education spending.

"If we want to keep our best teachers and prevent other states like Texas from raiding Oklahoma for talent, we're going to have to do a better job on salaries," said Oklahoma Governor Brad Henry (R).

Unfortunately, Oklahoma's efforts on behalf of elementary and secondary school teachers are rarely put into proper perspective. When differences in tax burden, living costs, employee benefits, and working conditions are taken into account, Oklahoma teacher salaries actually compare favorably to teacher salaries in other states, as well as to salaries of other workers in Oklahoma.

More Take-Home Pay, Better Benefits

According to the Washington, DC-based Tax Foundation, the "average tax rate—federal, state, and local taxes as a percent of income—is 26.5 percent in Oklahoma versus 30.0 percent for the nation as a whole." This is largely because Oklahoma is a relatively poor state with relatively few high-income earners paying the progressive federal income tax. Oklahoma's lower-than-average tax rate means every \$1,000 of gross pay in the state yields \$735 in take-home pay—5 percent more than the \$700 average for all U.S. workers.

For an Oklahoma teacher making the average salary, this represents a \$1,216 take-home "bonus." That Oklahoma teacher brings home \$1,216 more than her national counterpart making the same salary.

What's more, take-home pay goes further in Oklahoma. For example, "\$100 in the Oklahoma City metro area purchases goods that would cost \$111 in the rest of the U.S.," according to the most recent survey of the American Chamber of Commerce Researchers Association (ACCRA). Adjusting Oklahoma's teacher salaries to reflect this cost differential raises the salary average to \$38,566, an increase of \$3,822.

It should also be noted that the salary data exclude fringe benefits. Virtually all public school teachers are covered by defined benefit retirement plans, which pay scheduled monthly amounts throughout the employee's retirement. These plans differ from the defined contribution plans prevalent in most private companies, in which retirement benefits depend on the stock market and other investments.

Teacher retirement benefits are also usually indexed to inflation. Retired teachers often work in a new job while still receiving full pension benefits. As a result, teachers usually retire earlier than workers covered by Social Security

or a conventional pension plan.

Health insurance is nearly universal for public school teachers. Federal data show about one-half of teachers pay nothing for single-person insurance coverage, a benefit achieved by only 20 percent of professional and managerial employees in medium and large private firms. And only 10 percent of private firms pay the full premium for family policies, compared to 29 percent of public school districts.

Relative to their colleagues in surrounding states, Oklahoma teachers have generous benefit packages. Fringe benefits for K-12 instructional staff equal 21.3 percent of salaries in Oklahoma, according to Census Bureau data. By comparison, benefits average just 13.9 percent of teacher salaries in Texas, 19.2 percent in Kansas, and 18.9 percent in Colorado.

Total compensation, salary plus benefits, is estimated at \$42,134 for the average teacher in Oklahoma. That is within 5 percent of the average compensation received by teachers in every contiguous state except Colorado. And when taxes and living costs are taken into account, Oklahoma teachers are compensated better than teachers in most surrounding states.

Small Class Sizes another "Perk"

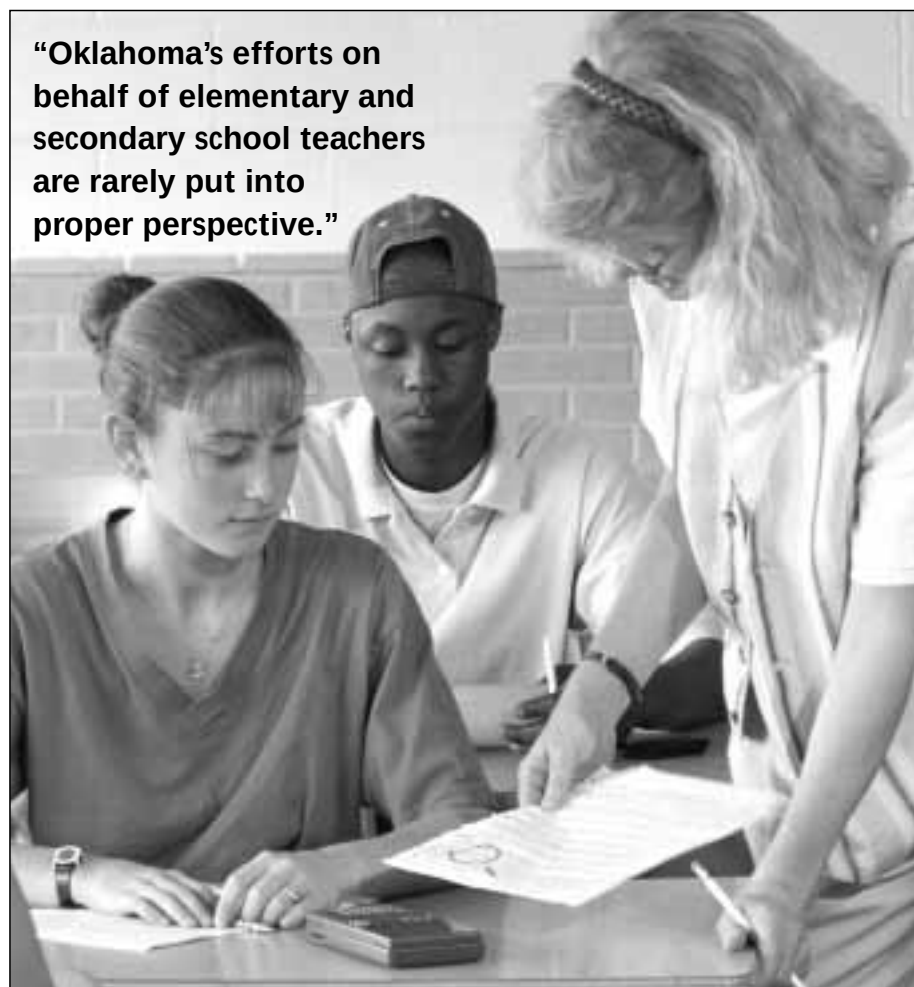
Oklahoma's student/teacher ratio (15.1 to 1) is also below the national average (16 to 1). Smaller classes give teachers better control while reducing the time they spend grading papers, meeting with parents, staying after school with students, etc. Small class size is therefore another "perk" not reflected in teacher salaries. It is a very expensive perk, however, requiring that more teachers be hired.

Had Oklahoma allowed its student/teacher ratio to rise to the national average, 2,324 fewer teachers would have been employed in 2000-01. Smaller class size explains why, despite its low rank on teacher salaries, Oklahoma is in the top half of states (22nd) when ranked on the percent of personal income spent on teacher salaries. In 2000-01 Oklahoma spent 1.89 percent of its personal income on teacher salaries; the national average was 1.84 percent.

An even more comprehensive measure of the state's efforts on behalf of education is found by tallying up all current K-12 spending, benefits, administrative costs, and salaries. When total expenditure on these items is measured relative to personal income, Oklahoma ranks 14th highest among the states. This is hardly a sign of a state not interested in quality education.

Edwin S. Rubenstein, president of ESR Research in Indianapolis, has served as a municipal bond analyst for Moody's Investors Service, senior economist at W.R. Grace & Co., contributing editor at Forbes magazine, and staff economist for the New York State Commission on Education. His email address is Edwin@esrresearch.com.

"Oklahoma's efforts on behalf of elementary and secondary school teachers are rarely put into proper perspective."



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Mixed Results Achieved by "Sin" Taxes in Nevada

by John Skorbura

A liquor tax hike implemented in Nevada in summer 2003 has done nothing to reduce alcohol use, but cigarette sales have slowed after an 80-cents-per-pack increase, the *Reno Gazette-Journal* reported on December 22.

At the time the tax hike was being debated, Duane Parde, executive director of the American Legislative Exchange Council, pleaded with his Nevada members not to raise taxes. "As I monitor the battle over taxes in Nevada, I am struck by the opportunity that you have to take a firm stand," wrote Parde. "The decisions you make will decide the path your state will take for years to come: more government and higher taxes, or efficient government and lower taxes."

"Can you honestly say that your state government is limited?" asked Parde. "That it functions only to protect the rights of the people? Can you honestly say necessary programs cannot be streamlined or outsourced? If not, then tax increases should be off the table."

Parde's efforts notwithstanding, taxes were hiked ... unnecessarily and counterproductively, observers now say.

"Government is looking to sock it to Nevada businesses and choking smokers with a tripling of the tobacco tax. This is all under the guise that state government is about ready to run out of money, when it isn't," said Doug French, executive vice president of a Southern Nevada bank and a policy fellow for the Nevada Policy Research Institute.

New state figures show Nevada residents and visitors "drank more alcohol, despite the 75 percent increase in the

liquor tax." Since the tax went into effect on August 1, the state has imported about one million more gallons of beer and 200,000 more gallons of wine and liqueurs compared to the same period the previous year.

"It's a social thing," George Sturgeon, 24, a Reno stockbroker, told *Gazette-Journal* reporter Anjeanette Damon. "If people want to drink to be social, they are going to drink."

"Where it hurts the most are the cheap vodkas and such," said Jamy Keshmiri, who owns four Ben's Fine Wine and Spirits stores in Reno and Carson City. "The customers, they were in kind of a shock. They come in one day and it's \$11.99, and the next day it's \$12.99. It kind of makes a big difference." He told Damon wine and beer sales are keeping up, but he's taken about a 20 percent hit in hard liquor sales.

Curtis Worrall, owner of Whispering Vine Wine Co. in Reno, said the increased liquor tax has "not affected the demand for wine." It has, however, cut into his profit margin. Phil Silver, a customer interviewed by Damon as he was buying wine at Whispering Vine, said he has bought some wine on the Internet, but he thinks "it's important to support local business."

"Don't do it again," said Silver, an operations manager for a Reno interior design firm. "I am not pleased. I would've rather seen cuts in the budget. If they had waited another two years, we would've recouped everything we lost because of 9-11."

Concerning cigarettes, the *Gazette-Journal* reported, "Many smokers said



"According to state tax officials, liquor taxes since the start of fiscal year 2004 have generated \$400,000 more than expected."

they aren't smoking less because of the tax, and smoke shop clerks said they haven't noticed a dip in sales." Instead, clerks said more people are buying roll-your-own tobacco, a pouch of which can yield 200 homemade cigarettes.

"At first, they liked to cuss me out, like I personally raised the tax myself," said Tracy Williams, a cashier at Smoke! Discount Cigarettes on Clear Acre Lane in Reno. "After a week of that, they haven't complained."

Stephanie Bell, a Carson City insurance agent, said she "isn't smoking less but is paying more attention to the price and is buying in bulk."

She recently walked out of one Carson City smoke shop to seek a cheaper price for Marlboro Lights down the road. "I'm

definitely buying by the carton now instead of by the pack."

According to state tax officials, liquor taxes since the start of fiscal year 2004 have generated \$400,000 more than expected. At the same time, the state has collected \$1.8 million less in cigarette taxes than expected.

"With respect to cigarettes, we don't know what is actually happening out in the marketplace," said Dino Dicianno, deputy tax director. "Have they quit smoking? Are they purchasing cigarettes across the border or on the Internet? What's going on?"

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Georgia

Continued from page 1

struggled a year ago to use budget cuts and reserves to close a \$620 million gap in the fiscal year 2003 budget. Perdue has been working ever since to rein in spending and lower expectations for 2004. He told departments to cut spending 2.5 percent in 2003 and 5 percent in 2004.

No New Taxes

According to the governor's Web site, Perdue "directed every state department to identify its core mission, associate a cost with every program, identify core customers, and rank programs in priority order." The result is a "responsible and balanced budget in 2004 based on priorities." The budget contains "no tax increases of any kind."

"The news in Georgia late last year was that the current [2004] fiscal year's state budget may have to be cut by another \$440 million to \$1 billion in order to balance it as required by the state constitu-

tion," said Bob Irvin, former state House Minority Leader and U.S. Senate candidate, now a management consultant living in Atlanta. "For Governor Sonny Perdue, this is nothing new. He has probably spent more of his first year on trying to solve the state budget crisis than on everything else put together. That is a double shame—first, because it's not his fault; and second, because it didn't have to happen at all."

"I will not allow anyone to make your struggle harder by reaching deeper into your pocket with a tax increase," said Perdue in his annual message to the citizens of Georgia. "If you have to live within your means, state government will too. We will not raise taxes to balance this budget."

According to Irvin, "Back in the roaring '90s, when the seeds of this crisis were sown, total state spending exploded. It more than doubled from Zell Miller's first budget (fiscal year 1992, \$7.55 billion) to Roy Barnes' last (fiscal year 2003, originally passed as \$16.5 billion), and it ended up running way past revenue collections."

Watch Spending

The Georgia Public Policy Foundation has

tracked state spending for every year since 1979 and measures it against such benchmarks as inflation and population growth. The numbers show "state government was Georgia's biggest growth industry in the 1990s, outrunning both population growth and inflation." Over that decade, spending increased 88 percent, while population was up 26 percent and the consumer price index 33 percent.

According to Kelly McCutchen, the foundation's executive vice president, "Government tends to get bigger year after year and spends more of taxpayers' money. It's a bigger group, a bigger bill, but some people still get more than others."

"Anyone who's dined out with a group of colleagues and made the mistake of agreeing beforehand to split the check evenly has experienced the sticker shock of a higher-than-expected bill," explained McCutchen. "It starts when someone who normally wouldn't order dessert if he were paying his entire check decides to splurge, rationalizing that the additional cost, split several ways, really isn't that high. The problem, unfortunately, is that most people in the group tend to think the same

way. Pity the poor responsible fellow who still had to pay his share of the large bill but didn't get any dessert."

Perdue also used his State of the State address to call for \$1 billion in new debt to fill a potential budget gap, but he cautioned against opening the state financial piggy bank. "You don't drive full-speed toward a cliff hoping that someone will build a bridge before you get there," Perdue said. "I will not put Georgia in the business of recklessly spending money we don't have and may not get."

The governor's budget anticipates a 4.7 percent rate of revenue growth. An optimistic revenue projection last year was tempered by more than \$300 million in spending cuts when tax collections were slow to rebound.

"Spending is fun," notes Irvin. "Dealing with budget cuts isn't, and if we would do a little less of the former, we'd have to do a lot less of the latter, and the people would be a whole lot better off for it."

John Skorbura is managing editor of Budget & Tax News. His email address is skorbura@heartland.org.

Cook County Businesses Burned by 450 Percent Cigarette Tax Increase

**“Remember Prohibition,”
tax increasers are told**

by John Skorburg

The Finance Committee of the Cook County (Chicago, Illinois) Board of Commissioners voted on February 3 to raise the county cigarette tax 450 percent, from 18 cents to \$1.00 a pack. On February 23, the full Board approved a fiscal year 2004 budget that included the tax increase.

The tax increase proposal, passed after what observers called “spirited debate” in the committee, will go into effect on April 1.

The new tax brings the cost of a pack of cigarettes in Cook County to \$5.63, including state, local, and federal taxes of \$2.53. Finance Committee members had rejected two alternative tax increases proposed by County President John Stroger (D)—a quarter-percent increase in the general sales tax and a 4 percent business lease tax.

Although he wants Stroger to cut spending rather than raise taxes, Commissioner Larry Suffredin nevertheless called the cigarette tax increase a victory. “The one thing that we have done is we have killed a lease tax and a sales tax,” he said.

Negative Economic Impact

Before it voted 9-8 in favor of approving the 82 cents-a-pack cigarette tax increase, the Finance Committee heard testimony from opponents and supporters of the measure.

“Smokers will continue to smoke,” testified local businessman Jay Kent. “We will simply lose their business.” He warned, “Businesses will close and employees will lose their jobs, further compounding the drain on the county treasury.”

“You want to be a hero? Why don’t you raise it to \$100 a pack and effectively make cigarettes illegal?” asked Robert Rinaldi, another business owner who spoke at the hearing.

According to the *Chicago Sun-Times*, the county’s revenue director, Barbara Bruno, said the hike likely would “cause cigarette sales to plunge 59 percent” in the county. She projected the tax hike would raise only an “extra \$32.7 million,” about “\$25 million short” of what’s needed to plug the county’s budget deficit.

“Anywhere you live in Cook County you are 30 minutes from buying cigarettes somewhere else,” Bruno said.

“Indiana is only 16 miles from my store,” noted a business owner at the hearing. Like many who spoke, he

insisted most smokers wouldn’t stop smoking, but would simply drive to other counties to buy cigarettes at a cheaper price.

The representatives of anti-smoking groups appeared to disagree. Several spoke at the hearing, supporting the cigarette tax because, they said, it would deter many people from smoking, saving lives and millions of dollars in health care costs. But tax opponent Rinaldi, who owns a White Hen Pantry in Lincoln Park, scoffed at the idea that commissioners were concerned about public health, maintaining the board was simply trying to raise revenue.

“This is nothing more than a ploy to get revenue,” said Rinaldi. “It’s an insult to me.”

Spending Cuts Urged

“As a responsible businessman, when my revenues are down ... I look for ways to cut,” Rinaldi said, suggesting the board should, too.

Analysts for the Civic Federation, a Chicago-based tax policy and government research organization, agreed, issuing a report in December 2003 that insisted the County could address its budget woes with spending cuts rather than tax increases. “We urge you [Cook County] to look at our cost side, not just your revenue side. The county does not have a revenue problem. It has an expenditure problem,” said Laurence Msall, the group’s president.

“We do need to tighten the belt,” acknowledged Commissioner Bobbie Steele (D-Chicago), who nevertheless supported the tax increase. “It’s a new day in Cook County.”

Turf Wars Next?

Commissioner Carl Hansen of Mount Prospect, who voted against the cigarette tax increase, told the *Daily Herald*, a suburban newspaper, “commissioners would actually be contributing to crime by making bootleg sales of cigarettes attractive.” Three people in New York, where cigarette taxes were hiked from eight cents to \$1.50 a pack, were recently killed in disputes over black-market territory, he said.

“Think of a carton. Think of \$55 (the new price for a carton). Think of how valuable that is and how portable that is,” Hansen said.



“Remember Prohibition. And that’s what we’re getting toward.”

John Skorburg is managing editor of Budget & Tax News. His email address is skorburg@heartland.org.

INTERNET INFO

The Civic Federation’s 28-page analysis of and recommendations for the fiscal year 2004 Cook County budget are available online at the group’s Web site, <http://www.civiced.org>.

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Kansas Senator Challenges Judge's Billion Dollar Tax Increase

by John Skorburg

On January 26, Kansas State Sen. Kay O'Connor announced her intention to work with "like-minded legislators" to block implementation of District Court Judge Terry Bullock's proposed billion-dollar tax increase. (See "Judge Orders Billion-Dollar Tax Hike in Kansas," *Budget & Tax News*, January 2004.)

In a December 2, 2003 ruling, Bullock declared the Kansas school finance system unconstitutional and gave lawmakers until July 1, 2004 to fix it.

Kansas spends \$2.6 billion—about 52 percent of its total annual budget—to educate nearly 445,000 students. Total state, local, and federal funding for the state's K-12 government schools approaches \$4 billion.

Bullock's decision came in response

to a lawsuit brought by mid-size school districts in Kansas, which alleged their schools are underfunded and that small districts with largely white student populations get more than their "fair share" of school funds. Bullock announced his decision a week after lawyers made their closing arguments in the case, which was originally filed in 1999.

Karl Peterjohn, executive director of the Kansas Taxpayers Network, called Bullock's ruling "judicial nonsense." O'Connor agrees.

"Terry Bullock's unconstitutional decision essentially nullifies the budget authority of the Kansas legislature, and replaces it with himself, an unelected judge," said O'Connor. "The billion dollars Judge Bullock proposes to spend in the middle of a Kansas budget crisis will have to come from somewhere. It's going to have to come from

handicapped services, from public safety, from roads and bridges, from agriculture. It is going to have to come from higher education, from homeland security, from welfare, from health care. And above all, it's going to come from taxpayers—from workers, farmers, and businessmen," O'Connor continued.

"The representatives of these interests were not represented in Judge Bullock's court when he reached his decision. But unless we act vigorously, they will all pay for that decision," O'Connor warned in a January 26 press release.

O'Connor noted in the release, "I propose to design for the people of Kansas



Sen. Kay O'Connor

the same right that Americans enjoy under the U.S. Constitution, Article III, S. 2. That is the right to restrain judges from legislating from the bench, and the right to impeach those who don't comply.

"Perhaps Judge Bullock should consider resigning. It would remove the specter of a billion dollars of judicially imposed, ill-

considered taxes, and free him to run for the legislature, where he could participate in law-making without violating his constitutional oath as a judge," O'Connor concluded.

John Skorburg is managing editor of Budget & Tax News. His email address is skorburg@heartland.org.

Michigan's Budget: Good Start, More Can Be Done

by Michael LaFaive

Michigan Gov. Jennifer M. Granholm (D) announced on December 18 that an agreement was reached to eliminate a \$920 million deficit in the 2004 fiscal year budget.

There were more real cuts made to Michigan's 2004 budget, by a Democratic governor and Republican legislature, than many observers anticipated. Terms of the agreement included a "six-month pause in the income tax rollback," with the money to be used to offset the shortfalls in other funds. Also included in the deal was an "additional \$12 million in administrative cuts to state government spending," as well as a four-year phase-in of the health care tax deduction for businesses.

"This agreement preserves the income tax cut scheduled for next year, balances our budget while protecting essential services, and reduces a tax burden on businesses that has penalized them for offering health insurance," said Senate Majority Leader Ken Sikkema (R-Wyoming). "This is a fair compromise that really is a good deal for the people of Michigan. With this short-term problem now out of the way, we'll be able to stay focused on long-term solutions for revving up Michigan's economy and creating jobs."

"I think the governor had a good first year in spite of very difficult fiscal times," said State Rep. Dianne Byrum (D-Onondaga), who serves as House Minority Leader. "The governor has dealt with the budget difficulties, which is a very

difficult task," Byrum said.

State Sen. Nancy Cassis (R-Novi) said the governor "worked under pressure to negotiate solutions to keep Michigan moving forward." But she told reporters some of the governor's weaknesses lie in projects she didn't handle correctly, such as road restoration.

"I think sometimes there is a bit of disconnection between herself and some of her department directors; I'm not sure they are always on the same page with the same message," Cassis said.

Even given this political posturing, the end results of the budget session were mostly encouraging.

State Budget Director Mary A. Lannoye announced on December 30 that Michigan closed its books on the year with a positive "unreserved fund balance of \$174 million in the General Fund." Those funds will be used to help balance the fiscal year 2004 budget.

Sacred Cows Dealt With

According to work done at the Mackinac Center for Public Policy, in many cases, state officials did not just "assume the needs of government were more important than the needs of those who pay for it." Some large and small sacred cows were either eliminated or put on a diet in 2003. For example:

- General operations spending on higher education was cut by \$193 million, which encouraged universities to look at cost-cutting strategies.
- Lawmakers reduced arts subsidies

by 47 percent, thus encouraging greater independence and self-reliance for cultural groups.

■ The Southwest Michigan Tourist Council no longer receives \$60,400 in subsidies to give away free fruit and Christmas tree corsages at the New Buffalo rest area. While the dollar amount is small, this signals a willingness to pay closer attention to what are and are not core functions of government.

■ Concessions from state employee unions helped pare back overly generous compensation, saving taxpayers more than \$200 million in the near term.

Unlike other states, Michigan closed its fiscal year 2004 budget deficit without a large tax increase. Neighboring Ohio, for instance, hiked its sales tax by 20 percent.

Michigan did delay an income tax cut and could have avoided doing so by further reducing spending. But even this cloud came with a small silver lining: an effective cut in the Single Business Tax.

Recommendations for Future

Mackinac Center researchers recommended the state should cut unnecessary spending further in 2005 and make structural changes that would lower the cost of government services.

Among the recommendations:

- Sell state assets including both fairgrounds (\$59.6 million), the Ralph A. MacMullan conference center (\$10 million), and other state lands. These "one-time" revenues should be used to lower

the state debt, which has leapt in recent years.

■ Repeal the Prevailing Wage Act. This single law absorbs \$400 million in state funds annually by effectively mandating union-scale wages on state construction projects. Simply exempting public schools from this special-interest favoritism, as Ohio has done, would save schools \$150 million each year.

■ Switch to a part-time legislature, joining the 41 other states that already have one. The annual savings would be \$40 million.

■ Competitively bid management of Michigan's prison system, for approximately \$250 million in annual savings.

Although large cuts still can be made without harming core government functions, the Granholm administration and Republican-controlled legislature should be commended for taking a step in the direction of fiscal responsibility.

Michael LaFaive is director of fiscal policy for the Mackinac Center for Public Policy. His email address is lafaive@mackinac.org.

INTERNET INFO

Visit the Mackinac Center Web sites at <http://www.mackinac.org> and <http://www.michiganvotes.org>.

Cook County Assessor Wants Property Tax Caps

by John Skorburg

In a January 28 article in the *Chicago Tribune*, Cook County, Illinois Assessor James Houlihan renewed his call for state lawmakers to "impose a 7 percent per year cap on increases in residential property assessments in Cook County."

"The assessment cap allows for certainty," said Houlihan, a Democrat. "It allows for our neighborhoods to improve without individual homeowners fearing that they can't remain in that neighborhood. It does not jeopardize any school funding, and it creates a protection against the rise for inflation of property values creating more of a burden on individual homeowners."

Houlihan said the cap "needs to be enacted by the end of April if it is to be applied to the second 2004 property tax installment bill," which is usually due in the fall.

On February 4, the Illinois House of Representatives rejected, by a 61-49 vote, Houlihan's proposed property tax cap measure, which focused only on Cook County.

State Rep. Lou Lang (D-Skokie), who sponsored the measure for Houlihan, said the rest of the state wasn't included because leaders from the other counties didn't ask. "Since no other counties actually asked to be involved in

the bill, we limited it to the one county that did ask," said Lang.

According to the *Tribune*, a spokesperson for House Speaker Michael Madigan (D-Chicago) said Madigan would "work with Houlihan to try and refine the proposal" so that it could win approval.

Said State Sen. Carole Pankau (R-Itasca), "A good idea is a good idea, regardless of whether it's proposed by a Republican or Democrat. Houlihan's bill makes sense for Cook County taxpayers. I think it makes just as much sense for every other Illinois homeowner."

"Chicago, along with Rockford, has lost more industrial jobs than any other area in the country," noted Rep. Dave Winters (R-Shirland). "Why do the bills that we pass only concern Cook County when it's good for the taxpayer, and you don't allow us to expand it to the rest of the state?"

Broader Proposal Made

In a recent mailing to constituents, Pankau reported she had introduced HB 4068, which would limit increases in property tax assessments to 7 percent per year statewide. "In many suburbs, increased property values can lead to 30 percent, 50 percent, or even higher increases in assessments and property taxes," she said. The proposal also increases the Illinois homeowner's exemption from \$3,500 to \$4,500 and the senior exemption from \$2,000 to \$2,500.

State Rep. Lee A. Daniels (R-Elmhurst) wants property tax caps for DuPage County. "Many DuPage County residents are experiencing skyrocketing property values, and their property taxes are reflecting that," Daniels

"A good idea is a good idea, regardless of whether it's proposed by a Republican or Democrat. Houlihan's bill makes sense for Cook County taxpayers. I think it makes just as much sense for every other Illinois homeowner."

STATE SEN. CAROLE PANKAU

said. "While we have local tax caps in place that limit the amount of money government can increase its spending, rapidly increasing home assessments are putting a greater burden on families while commercial property taxes change very little. This shift of burden onto the backs of homeowners is hard for seniors, people on fixed incomes, and families experiencing difficulty during these tough economic times."

Daniels, a Republican, backs state legislation to alleviate the problem and has said he will introduce in the House

a bill similar to the one Pankau introduced in the Senate. Daniels' legislation also will provide a safety net for those who believe the state might eliminate tax caps in the future.

"The system is broke," Houlihan said. "We fund schools from property taxes, making the property tax too high. And in that context, [even] \$1 more for an individual homeowner [in taxes] is too much."

Business, School District Opposition

The Houlihan/Lang bill was opposed by the Chicagoland Chamber of Commerce and suburban school districts, who warned "it would shift a greater property tax burden to businesses and drain resources from some school districts."

"Our estimates with some of our partners show that it'll be a \$3 billion shift onto the business community, those small owners of two and three flats," said Jerry Roper, CEO of the Chamber. Roper says businesses already pay 51 percent of all taxes.

The first installment of Cook County property tax bills was mailed to property owners in late January. Those bills will not reflect the effects of the 2003 reassessment of city property. That will come in the second installment later in the year.

John Skorburg is the managing editor of Budget & Tax News. His e-mail address is skorburg@heartland.org.

Nebraska Governor Recommends No Increase in State Taxes

by John Skorburg

Nebraska Governor Mike Johanns (R) delivered his State of the State address on January 15. While he recommended no increase in state taxes, Johanns opened the door wide for higher property taxes. The Senate Education Committee considered such a plan at a January 27 hearing.

"We begin with a budget deficit that must be addressed," Johanns noted. "The budget I submit to you provides balance with no tax increases. It includes funding for several priorities that demand our attention and resources."

According to a January 27 news report on WOWT Channel 6, property taxes in the state could increase by as



Gov. Mike Johanns

much as \$54 million under a plan supported by Johanns. The governor, school groups, and others say the proposal is needed "given the state's current financial condition."

Not enacting the property tax increase would force "sizable sales or income tax increases, dramatic cuts to state programs, or a revenue miracle," said Sen. Ron Raikes (Lincoln), chairman of the Senate Education Committee, who introduced the proposal as LB 1093 on behalf of the governor. He added, "Schools should first do all they can to save money before resorting to raising taxes."

Johanns' proposal would lift a property tax cap imposed by the state legislature in 1998. That year, the cap was

set at \$1.10 per \$100 of assessed value. In 2001, the cap fell to \$1.00 per \$100 of assessed value. In 2003, the state legislature adopted a plan that would give schools an additional nickle in levy authority in 2003 and 2004, raising the cap to \$1.05, after which it would fall again to \$1.00, which would become the permanent cap. Johanns wants to make the cap permanent at \$1.05 per \$100 of assessed value.

By making permanent the higher property tax cap and tweaking the school aid formula, the state would spend \$168 million less in aid to schools over the next two years. The burden to cover additional funding for schools would fall on property taxpayers.

Johanns has denied that allowing schools to tax more will automatically translate into property tax increases. The decision whether to raise taxes "rests with schools," he has said.

The Nebraska Farm Bureau opposes Johanns' two-part plan. "Our members do not like property taxes," said Jay Rempe, a spokesperson for the group, at the January hearing. While he understands the state faces a budget shortfall, Rempe said if the levy is going to be kept higher it should be temporary and not permanent as is proposed.

After the hearing, the Senate Education Committee went into executive session. Three of the five members present said they, too, wanted the \$1.05 tax cap to be temporary. "That would make taxpayers feel better," said Sen. Elaine Stuhr (Bradshaw).

The committee took no action on the bill.

John Skorburg is the managing editor of Budget & Tax News. His e-mail address is skorburg@heartland.org.

HOT Lanes Advance in Seven States

HOT lanes enable cities and states to relieve congestion during a time of tight budgets



by Robert W. Poole, Jr.

High-occupancy toll (HOT) lanes made major gains in 2003 as federal, state, and local officials endorsed either the concept or specific project proposals.

A December 29 article on the *Washington Post's* Web site, washingtonpost.com, described succinctly how HOT lanes remain free to carpools, van pools, and buses, while other motorists pay a toll. The tolls are collected via electronic transponders, to prevent tollbooths from slowing or stopping traffic. To make sure the lanes don't fill up with cheaters, effective HOT lanes have room built in for police to ensure that vehicles have transponders.

HOT lanes are most effective, noted the article, when "the toll's price changes throughout the day to keep traffic moving, even during rush hours. When the lanes start to bog down, the price goes up to encourage motorists to leave the lanes or discourage them from entering. As road space frees up, the price drops. The fluctuating prices not only keep traffic moving, advocates say, but also 'stretch the highway's capacity by encouraging drivers to use it outside peak times.'"

According to the article, "HOT-lane advocates also tout the long-term potential for such lanes to improve transit." If a network of HOT lanes could be developed long-term to connect free-flowing toll lanes on several major highways, it could form a seamless web for express bus service.

Promising Possibilities

The Washington Beltway (I-495) is one of the highest-profile locations for proposed HOT lanes, and an unsolicited proposal to add two such lanes in each direction on 12 miles of the Beltway received the formal endorsement of Virginia's Commonwealth Transportation Board in July 2003. The Fluor Daniel company submitted a detailed proposal for the \$630 million project in October.

"We are out of money in our transportation trust funds throughout our region," said Lon Anderson, spokesman for the Mid-Atlantic AAA. "There's no

money to make the wholesale changes many would like to see. HOT lanes offer that opportunity."

The HOT lanes alternative will be included in the region's ongoing Final Environmental Impact Statement, to be wrapped up by December 2004. The project has strong local support (e.g., unanimous endorsement by the Fairfax County Board of Supervisors) but is opposed by the Fairfax Coalition for Smarter Growth, which is promoting light rail instead.

Philip Shucet, head of the Virginia Department of Transportation (VDOT), has praised the proposal as "a shining example" of a public-private partnership. VDOT will look at further applica-

clides, "HOT/managed lanes and other congestion pricing strategies hold the greatest promise for implementing value pricing in this region at this time."

The task force looked at the possible addition of HOT lanes on 17 miles of Georgia 400 north of I-285; shifting from flat-rate to variable pricing on the tolled portion of Georgia 400; and adding HOT lanes to Georgia 316. Georgia DOT is also looking into the possibility of a network of HOT lanes on the entire free-way system.

A HOT lanes network was proposed in July 2003 by the highest-ranking official in greater Houston, Harris County Judge Robert Eckels. Eckels asked county officials to look at the feasibility of

lanes on I-394. Washington's Transportation Commission directed the state DOT in January 2003 to study the feasibility of converting an existing HOV lane to HOT. In December, the state DOT decided to proceed with detailed planning for converting the SR167 HOV lanes to HOT lanes.

The nation's pioneer HOT lanes project, the 91 Express Lanes in Orange County, California, had another price increase. The busiest hours of the week—eastbound on Thursday and Friday between 4:00 and 6:00 p.m.—will now cost motorists \$5.50 instead of the previous \$4.75. The August 1, 2003 increase is the seventh since the Express Lanes opened in December 1995.

Though political pressures led the Orange County Transportation Association (OCTA) to buy out the privately developed project effective January 1, 2004, the hopes of some officials that tolls could be reduced or eliminated have been dashed.

In addition to needing toll revenues to pay off more than \$100 million in construction bonds, OCTA officials have come to appreciate the worth of the value pricing pioneered on these lanes. It's value pricing—increasingly higher rates during the busiest periods—that keeps the Express Lanes free-flowing and able to handle more vehicles/lane/hour at rush hour than the congested regular lanes.

Robert W. Poole Jr., an internationally recognized expert on privatization and transportation policy, is director of transportation studies and founder of the Reason Foundation. His email address is bobp@reason.org.

"Harris County [Houston, Texas] Judge Robert Eckels ... asked county officials to look at the feasibility of having the Harris County Toll Road Authority take over the 100 miles of HOV lanes now operated by Houston Metro, the regional transit agency."

tions of HOT lanes in the DC metro area using a \$500,000 grant from the federal Value Pricing Pilot Program, announced in July 2003. The pilot program is also supporting further work on several other HOT lanes projects:

- A \$1 million grant will help Colorado DOT plan the conversion of the High-Occupancy Vehicle (HOV) lanes on I-25 North to HOT lanes.
- Florida DOT will do detailed traffic and revenue studies of a potential HOV-to-HOT conversion on I-95 in Miami.
- Texas DOT will study the addition of HOT lanes to a 15-mile section of the Northeast Corridor in San Antonio.

Other Positive Steps

In August 2003, the Atlanta Value Pricing Advisory Task Force released its report after a nearly two-year effort to evaluate how traffic pricing might help address metro Atlanta's severe congestion problems.

"Paying the Price for Congestion" con-

having the Harris County Toll Road Authority take over the 100 miles of HOV lanes now operated by Houston Metro, the regional transit agency.

The HOV lanes were developed originally as express busways, but were opened to carpools because they have significant excess capacity. Two of those facilities on I-10 and US 290 already have been converted to HOT lanes, and the I-10 HOT lanes will be greatly expanded in a \$1.4 billion reconstruction project that began in June 2003. Metro would be ensured access for its large fleet of express buses but would no longer have to pay to maintain the limited-access lanes. Toll revenues will make it possible to expand the network of lanes.

Minnesota and Washington State also are moving into the HOT lanes camp. Minnesota enacted new legislation in summer 2003 that permits the conversion of HOV lanes to HOT lanes. The first project, as recommended by a Value Pricing Task Force, will convert the HOV

INTERNET INFO

For more information on value pricing, visit the Value Pricing Homepage maintained by the Hubert H. Humphrey Institute of Public Affairs at the University of Minnesota, <http://www.hhh.umn.edu/centers/slp/projects/conpric/>.

Schwarzenegger Discusses Outsourcing Opportunities

by Adrian Moore and George Passantino

In his January 6, 2004 State of the State speech, California Gov. Arnold Schwarzenegger (R) had some great lines, like, "If I can sell movies like 'Red Sonja' and 'Last Action Hero,' I can sell California." And, "The executive branch of this government is a mastodon frozen in time and about as responsive."

To break the ice around California agencies and the state budget, Schwarzenegger is going to need all of those sales skills and more.

Schwarzenegger likened the state to a "family that has run up an impossible debt on its credit cards." Now California faces the really tough step those families also must take—changing the behavior that resulted in the debt in the first place. Without a change in behavior, the debt is bound to come back.

Schwarzenegger argued the state suffers "not a tax revenue crisis, but a crisis of spending." He made it clear he planned to take on the fiefdom-driven politics of California state government in order to consolidate duplicative and overlapping state programs. Not content to just "move the boxes around," he intends to "blow them up."

Among his key proposals:

- a Performance Review Commission that will systematically audit state programs to ensure they are worthwhile investments. This will be an important step moving California toward a system that bases budget decisions on performance rather than preference and politics.
- repeal of SB 1419, which severely restricted local

schools' ability to competitively contract for non-instructional support services. The Governor will give schools more purchasing power by allowing them to shop around for the best services. Doing so will help them confront the painful budget realities.

■ "a Constitutional amendment to allow for competition in government through outsourcing opportunities." The Schwarzenegger administration "will be pursuing a new Constitutional amendment to ... permit the State to contract with non-State entities for ministerial functions whenever doing so will reduce costs, improve efficiency, or improve services."

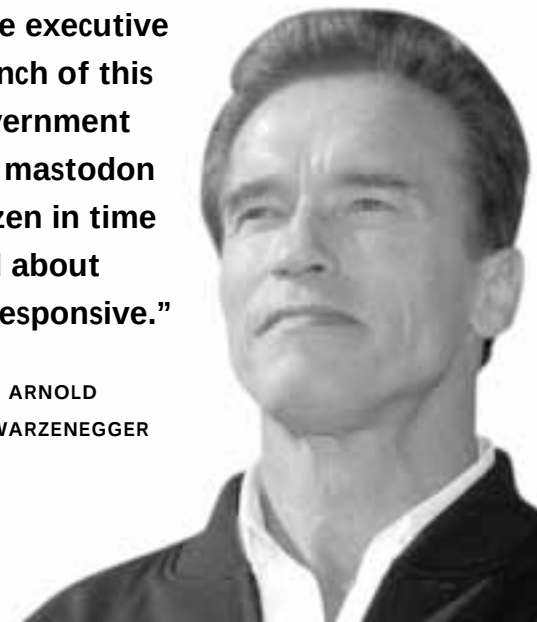
If Schwarzenegger follows through on that last promise, he will be opening a much-needed discussion in California, and nationwide, about the wisdom of laws that ban competition and privatization outright rather than letting those policy tools sink or swim on their own merits. It will be an uphill battle, but well worth the effort.

Schwarzenegger also wielded very publicly what may become his policy weapon of choice—taking his agenda straight to the public in the form of ballot measures. Will the legislature follow his lead and enact significant reforms? The battle will be exciting to watch ... but our guess is they will.

Adrian Moore is vice president and George Passantino is director of government affairs at the Reason Foundation in Los Angeles. Their email addresses are adrian.moore@reason.org and gpassantino@reason.org, respectively.

"The executive branch of this government is a mastodon frozen in time and about as responsive."

GOV. ARNOLD SCHWARZENEGGER



INTERNET INFO

Gov. Arnold Schwarzenegger's State of the State address, delivered January 6, 2004, is available on the Internet at http://www.governor.ca.gov/state/govsite/gov_homepage.jsp.

California Study Says Public Housing Costs More Than Private

by John Skorburg

"The road to state-subsidized housing may be paved with good intentions, but it's marked by an unavoidable fact: It actually costs more to build housing that costs less," reported the *Bakersfield Californian* in a January 25 story addressing a University of California - Berkeley study that reviewed the costs associated with building government-subsidized housing.

The study, first released in September 2003 and updated in January 2004, discovered subsidized housing costs more to build than similar housing built by the private sector.

"University of California at Berkeley's center on real estate and urban economics has taken a look at the costs of building low-income housing and found that state-subsidized housing costs between 10 percent and 32 percent more to build than private housing projects," explained Dr. Adrian Moore, vice president of the Los Angeles-based Reason Foundation. "The short story is that state subsidies come with politics, and from politics come requirements that drive up costs."

In November 2002, California voters approved Proposition 46, a \$2.1 billion bond measure dedicated to affordable housing development and related programs. About half those funds—roughly \$1 billion—are directed to new multifamily construction. The Berkeley study suggests taxpayers would save between \$100 million and \$320 million if that multifamily housing were built by the private sector.

According to Moore and the *Californian*, the UC-Berkeley study offers three explanations for why public housing costs are higher than in the private sector:

- higher design standards, to "blend in and temper neighborhood opposition to lower-income projects."
- longer turnaround times, because "nonprofit developers spend [more time] chasing other financial sources to put deals together."
- state laws, especially those that "require the highest prevailing union wages on projects built with public funds."

Prevailing Wage Laws a Key Culprit

According to the *Californian*, the study "estimated that union-supported prevailing wage laws typically drive up construction costs 10 to 20 percent."

"There can be little doubt that prevailing wage requirements in California substantially increase the cost and decrease the supply of dwellings available to low- and moderate-income households," reported the study, conducted by analysts in the University's Fisher Center for Real Estate and Urban Economics.

California has budgeted "\$1.1 billion for low and moderate-income apartments and supportive facilities," said Richard Friedman, chief counsel of the state's Department of Housing and Community Development. Prevailing wage laws apply to all of that construction.

"It's really a political transfer of subsidies from housing to workers," said Larry Rosenthal, a coauthor of the Berkeley



INTERNET INFO

Working Paper No. W03-003, "The Effects of Prevailing Wage Requirements on the Cost of Low-Income Housing," is available online at <http://urbanpolicy.berkeley.edu/pdf/DQR0104.pdf>.

study. "That might be a good thing or a bad thing, but it does have a price."

Prevailing wage laws date back to the Great Depression of the 1930s and the 1931 passage by Congress of the Davis-Bacon Act. According to the study, Davis-Bacon was intended to "preserve jobs and wages for local construction workers." Traditionally, the federal government awarded construction contracts to the lowest bidder. Davis-Bacon sought to "limit a contractor's ability to lower wages for its workers in order to win contracts" and also to discourage non-local firms from competing for government contracts and "driving down wage rates."

California's prevailing wage law was passed in 1931, the same year as the federal act. A 1995 study of state prevailing

wage laws found California's to be one of the most stringent in the nation. The California law was updated slightly in 2001 to address ambiguity regarding interaction between the state law and its federal counterpart.

"One of the Berkeley authors argues that state rules are just a means of shifting money from the low-income housing program to unionized construction workers," noted Moore. "I would add to the analysis the observation that private housing development does the most to increase the supply of housing and thereby create affordable housing."

John Skorburg is managing editor of Budget & Tax News. His email address is skorburg@heartland.org.

Agenda

Continued from page 1

raised taxes and cut spending.

"It's the most dire situation we've seen in over 20 years," noted Raymond C. Scheppach, executive director of the National Governors Association, in a recent ALEC report. "Governors are dealing with unprecedented fiscal pressure. Even as the economy turns around, the state budget forecast will remain stormy since revenue growth lags the recovery by at least 12 to 18 months."

Increasingly, the states are also looking to Congress for reinforcements in their war against red ink. In particular, state lawmakers and revenue officials are lobbying Congress on four fiscal issues: remote collection of state sales and use taxes, business activity taxes, the Internet tax moratorium, and emergency federal assistance for the states. All four are viewed by state policymakers as crucial to the future fiscal health of the states.

State Sales and Use Taxes

The collection of state sales and use taxes has been controversial for some time, dating back to the early days of catalog sales. The Supreme Court ruled in the 1992 *Quill* decision that states could "only require sales and use tax collection from vendors with a physical presence in a particular state." The ruling hinged on the undue burden vendors

"Legislation was introduced in Congress to require a physical presence for state taxation of business activities, and several states are considering legislation as well. The complexity of the issue leads some analysts to doubt whether any action will come quickly."

would bear if they were expected to collect sales and use taxes in multiple jurisdictions and the adverse impact this would have on interstate commerce.

With the advent of the Internet after *Quill* was decided, state tax officials fear an erosion of their sales tax bases as more and more people purchase goods from out of state. To address that concern, "legislation has been introduced [in Congress] that would allow states to enter into a multi-state compact for purposes of collecting sales and uses taxes on interstate commerce," said Adam Thierer, director of telecommunication studies at the Cato Institute.

The proposed compact, called the Streamlined Sales Tax Project (SSTP), seeks to "reduce the burden placed on vendors" who would potentially have to collect sales and use taxes for thousands of tax jurisdictions. SSTP is hopeful Congress will overturn the *Quill* decision if enough states voluntarily simplify their sales tax systems. Many businesses

would appreciate tax simplification and thus support SSTP, and many state tax officials support it because they believe it will allow them to reap billions in new sales tax revenues.

Lee Goodman, an attorney who specializes in state tax issues that affect interstate commerce, nevertheless thinks Congress is unlikely to act on SSTP in the near future. "It is unlikely that Congress would vote to expand sales taxes to interstate commerce in 2004 because too few states have brought their laws into complete conformity, there has been no demonstration that an interstate sales tax software can work seamlessly in the mainframes of all businesses in America, and it's an election year."

Business Activity Taxes

The collection of state business activity taxes (BAT) is also a focus of debate in Congress. States impose a variety of business taxes, including corporate income taxes, franchise fees, and gross receipts taxes. States have typically levied these taxes on businesses with a physical presence, such as an office or warehouse, but the twenty-first century economy transcends state borders. The Multistate Tax Commission estimates states are "losing \$9 billion per year in uncollected taxes on business activities."

State revenue officials are more aggressively seeking to collect business activity taxes. New Jersey tried to charge a software company based in South Carolina more than \$500 a year in business activity taxes simply because the company derived \$49 in revenues from a New Jersey customer. Similar situations are occurring in states across the country.

Legislation was introduced in Congress to require a physical presence for state taxation of business activities, and several states are considering legislation as well. The complexity of the issue leads some analysts to doubt whether any action will come quickly. "It is unlikely that Congress will pass BAT reform this year," predicted Goodman, "in part because the issue is complex and will compete with other major legislative initiatives of higher priority."

Goodman also thinks the BAT issue could be coupled with SSTP, and Thierer agrees: "It remains unclear if a legislative quid pro quo could be brokered to try to appease all the interests in these debates," Thierer said.

Internet Taxation

The third congressional issue related to state tax collection is the Internet Tax Freedom Act (ITFA). Originally passed in 1998, the ITFA forbids state taxation of Internet access (unless taxed prior to the enactment of the ITFA) as well as multiple and discriminatory state taxation of interstate commerce. The act expired in 2003. A bill to make the moratorium permanent passed the House of Representatives in the fall of 2003, but the measure has stalled in the Senate.

Several lawmakers, including Sen. Lamar Alexander (R-Tennessee), see the ITFA as an attack on state sovereignty. "This is not about the Internet, it's not about taxes. It's about governors, and



Marilyn Maxfield

Nevada's Legislative Commission, shown here meeting on December 15, 2003, acts when the full legislature is not in session. Six states—Arkansas, Montana, Nevada, North Dakota, Oregon, and Texas—are not in regular session this year.

mayors, and legislators who can make their own decisions about what services to provide and what taxes to raise," he said. "If this were to succeed, the next crop of candidates for the United States Senate would run on the platform for abolishing the state income tax."

The ITFA contains language protective of state tax sovereignty. Dan Mitchell, an economist with The Heritage Foundation, is more concerned about what might happen to states if the ITFA is not made permanent. "I fear that the economy might be hurt if the moratorium is not extended—and that has a stronger impact on state revenue than any taxes that might be imposed on online activity."

John Berthoud, president of the National Taxpayers Union, agreed. "The states have seen a large increase in revenues in recent years and can do just fine without getting their claws on one more area of commerce."

State Bailouts

The final state fiscal issue Congress may have to address in 2004 is another federal bailout for the states.

In 2003, after intense pressure was applied by state governments for as much as \$100 billion in emergency budget assistance, Congress relented and provided \$20 billion for state budget deficits. Congress did place some restrictions on the use of the funds, most importantly that the federal money could not be used to start new programs.

Critics of the bailout found little comfort in the restrictions, however. "Taxpayers who live in fiscally responsible states like Colorado and New Mexico should not have to fund the excesses of states like California," said Michael New, an adjunct scholar for the Cato Institute. New thinks a better approach would be for Congress to provide funds only to states with tax and expenditure limitations.

The Heritage Foundation's Mitchell expects the states to ask for more in 2004. "Politicians always want more money to spend. The \$20 billion spent last year almost certainly encouraged

states to defer much-needed reforms, so we can expect demands for more handouts this year."

Good News and Bad News

With complex issues like SSTP, BAT, ITFA, and federal bailouts, it can be easy to miss the forest for the trees. What is the state of fiscal federalism in 2004? Richard Vedder, an economics professor at Ohio University, says there is good news and bad news on that front.

"Politicians always want more money to spend. The \$20 billion spent last year almost certainly encouraged states to defer much-needed reforms, so we can expect demands for more handouts this year."

"The good news is that there is a great deal of tax competition between states, and the effect of it has been to lower tax burdens on the whole, and in particular in high-tax states," Vedder said.

And the bad?

"There are growing forces at work to 'harmonize' taxes, which has the potential impact of restricting tax competition," Vedder said. Some of the proposals are well-intentioned, he believes, but "imposing one-size-fits-all standards on the states threatens the vibrancy of our 'laboratories of democracy.'"

Chris Atkins is director of tax and fiscal policy for the American Legislative Exchange Council. His email address is cdatkins@alec.org

INTERNET INFO

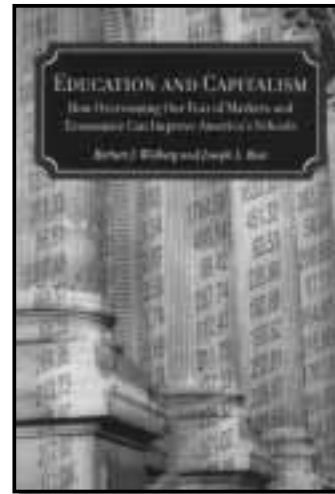
For more information visit the ALEC Web site at <http://www.alec.org>.

2004 Session Dates

State	Convenes/ Reconvenes	Projected/Actual Adjournment
Alabama	02/03/04	05/17/04
Alaska	01/12/04	05/11/04
Arizona	01/12/04	04/04
Arkansas	Not in regular session	
California	01/05/04	11/30/04
Colorado	01/07/04	05/05/04
Connecticut	02/04/04	05/05/04
Delaware	01/13/04	06/30/04
District of Columbia	01/06/04	12/04
Florida	03/02/04	05/01/04
Georgia	01/12/04	03/04
Hawaii	01/21/04	05/05/04
Idaho	01/12/04	04/04
Illinois	01/14/04	05/04
Indiana	01/06/04	02/04
Iowa	01/12/04	No specified adjournment date
Kansas	01/12/04	04/04
Kentucky	01/06/04	60 days
Louisiana	03/29/04	06/21/04
Maine	01/07/04	04/21/04
Maryland	01/14/04	12/04
Massachusetts	01/07/04	01/04/05
Michigan	01/14/04	12/04
Minnesota	02/02/04	05/17/04
Mississippi	01/06/04	05/09/04
Missouri	01/07/04	05/30/04
Montana	Not in regular session	
Nebraska	01/07/04	04/04
Nevada	Not in regular session	
New Hampshire	01/07/04	05 or 06/04
New Jersey	01/13/04	12/2004
New Mexico	01/20/04	02/19/04
New York	01/07/04	12/31/04
North Carolina	05/10/04	summer 04
North Dakota	Not in regular session	
Ohio	01/04	No adjournment date yet
Oklahoma	02/02/04	05/28/04
Oregon	Not in regular session	
Pennsylvania	01/06/04	11/30/04
Rhode Island	01/06/04	No specified adjournment date
South Carolina	01/13/04	early 05/04
South Dakota	01/13/04	12/04
Tennessee	01/13/04	06/04
Texas	Not in regular session	
Utah	01/19/04	03/03/04
Vermont	01/06/04	mid 04/04
Virginia	01/14/04	03/13/04
Washington	01/12/04	03/11/04
West Virginia	01/14/04	03/11/04
Wisconsin	01/20/04	05/12/04
Wyoming	02/09/04	03/03/04

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Farm Group Makes Fairer Taxes a Priority

by Roger W. Buchholtz

At its national convention in Honolulu, Hawaii on January 14, the American Farm Bureau Federation (AFBF) moved to make replacing the federal income and payroll tax systems a priority concern for 2004.

The AFBF board named HR 25 and S 1493, commonly known as the FairTax legislation, among its top priorities for education and lobbying efforts by its five million members. The legislation, currently pending in Congress, would replace income and payroll taxes with a national retail sales tax.

"The FairTax has been in our policy book for years," stated AFBF President Bob Stallman. "It does address many of our policy issues on federal tax reform, including estate taxes, capital gains, alternative minimum, and more. With this vote of the board, we'll be taking a good look at how the FairTax proposal compares to our current tax system and our desire for needed reforms."

During the AFBF convention, FairTax advocate Tom Wright, who is executive director of FairTax.org, campaigned for farmer and rancher support of the House and Senate measures, which are already gaining support on Capitol Hill. FairTax.org has spent the past year working with more than 30 state farm bureau organizations in a coordinated, nationwide effort to raise awareness among farm bureau leadership of the bill's details, laying the groundwork for the AFBF board's policy vote.

"Internationally, income and payroll taxes and the cost of compliance burden our farm exports, making them less competitive on the world market," Wright told farmers in a speech hosted by *Budget & Tax News*. "Domestically, the current system targets our working poor for abuse, while burdening them with regressive Social Security taxes. The FairTax improves export competitiveness across the board—not just for agriculture—while relieving the burden on our working poor and creating much needed jobs."

According to Wright, the FairTax proposal is designed to be "revenue neutral," raising the same amount of revenue as do personal and corporate income taxes, payroll and Social Security taxes, and gift and estate taxes. Those taxes would be replaced with a system 90 percent smaller, less intrusive, and less expensive. A dedicated income stream from the broad-based sales tax would replace the narrow, regressive payroll tax currently used to fund Social Security and Medicare.

The FairTax measure would take farm and ranch producers "out of the tax system entirely," said Wright, as long as their operations are not involved in retail sales.

"With the FairTax, farmers are out of the tax business entirely," continued Wright. "No record keeping, no filing, no complex planning, no audits, no alterna-

What Is the FairTax?

The FairTax, pending in Congress as HR 25 and S 1493, is a non-partisan proposal that would abolish all federal income taxes, including payroll, self-employment, alternative minimum, income, capital gains, corporate and death taxes, replacing them with a simple, visible, federal sales tax.

The FairTax is designed to be revenue-neutral, raising no more and no less than what is currently raised through the taxes it would eliminate. It taxes Americans only on what they spend, not on what they earn.

FairTax advocates say it is a fair, efficient, and intelligent solution to the frustration and inequity of our current tax system, which particularly burdens poor Americans and fixed-income retirees. The FairTax proposal includes specific protections for those Americans, including ending the narrow, regressive Social Security tax, ending income taxes, and rebating other federal tax liabilities to Americans (with a legal Social Security number) whose annual incomes are less than poverty level.

What Is FairTax.org?

FairTax.org is a nonprofit, nonpartisan, grassroots organization dedicated to replacing the current tax system. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the group's Web site at <http://www.fairtax.org> or call 1-800-FAIRTAX.

tive minimum tax, no self-employment taxes, nothing. The only place the tax is charged is 'under the bright lights of the retail counter' to the person who's going to wear the gloves or drive the car. There are no hidden taxes cascading through the system. Producers will make business decisions based solely on what is best for their farm and family, not tax consequences."

The FairTax measure is sponsored in the House by Reps. John Linder (R-Georgia) and Colin Peterson (D-Minnesota), and in the Senate by Sens. Saxby Chambliss (R-Georgia) and Zell Miller (D-Georgia).

Roger W. Buchholtz is Michigan's state director for FairTax.org and president and founder of Orient American Ore Company. His email address is roger.buchholtz@fairtaxmi.org, or he can be reached by telephone at 269/345-0950.

Letter to Health & Human Services

Taxpayer Group Seeks to Save Feds \$12.6 Million



February 5, 2004

The Honorable Tommy Thompson
Secretary

Department of Health and Human Services
200 Independence Avenue SW
Washington, DC 20201

Dear Secretary Thompson:

On behalf of the 350,000-member National Taxpayers Union (NTU), I write to request that the Bush administration immediately terminate the planned \$12.6 million ad campaign on behalf of the forthcoming Medicare prescription drug benefit. We also ask you to cease all other publicly funded expenditures on items such as mailings and meetings which seem to be little more than public relations efforts to build support for this expensive new program.

Given that the heart of the new program doesn't begin until 2006, it is very hard to draw any conclusion about advertising this year other than that it is focused much more on the coming elections. While your "Same Medicare. More Benefits" campaign may be welcomed by politicians running for election in 2004, we can see little public benefit from a campaign beginning two years prior to the commencement of prescription drug insurance.

Even when there is no election agenda, NTU and fiscal conservatives across the country deplore taxpayer-funded advertising promoting big government. The outrage is compounded by your Department's recent embarrassing admissions that the prescription drug program will cost far more than what was promised to the American public last fall. These revelations are no surprise to NTU or the 45 citizen, taxpayer, and conservative groups from around the country who joined us in opposing this measure. Our broad coalition repeatedly warned wavering Members of Congress that this would be the case (supporters, of course, assured otherwise). We believe these belated admissions of the true cost provide one more reason to shut down all HHS advertising efforts.

The Medicare prescription drug legislation has added trillions to the unfunded liabilities facing the nation. This \$12.6 million ad campaign, timed in accord with the 2004 elections rather than the start of the program, adds insult to injury, and we believe the American public would be best served by its immediate termination.

Sincerely,

John Berthoud

President, National Taxpayers Union

cc: All Members of the U.S. House and Senate

Corporations Don't Pay Taxes, People Do

by Stephen Slivinski

When Democrats on the Presidential campaign trail talk taxes, attacks against the Bush administration are *de rigueur*. The Bush tax cuts, they complain, benefitted big corporations rather than individual taxpayers.

Former Vermont Governor Howard Dean's Web site lamented that "corporate income tax revenues have declined as a share of the federal tax take." The tax cuts "worked to shift the tax burden away from corporations," complained Connecticut Senator Joe Lieberman's Web site. The promise that their plans "would make corporations pay their fair share" apparently wasn't enough to attract voters, and Dean and Lieberman are both out of the race.

Even front-runner John Kerry is a "fair share" man. According to Washington, DC economist J. Edward Carter, Kerry "routinely preaches that corporations should pay their 'fair share' of the nation's tax burden. That sounds like a no-brainer. But it isn't."

Continues Carter, who is chairman of Economists for Bush, "As most college freshmen learn in Economics 101, corporations do not pay taxes, people do. The burden of corporate taxation is ultimately borne by customers (through higher prices), stockholders (smaller div-

idends and capital gains), and employees (lower wages)."

But in an election year, politics regularly trumps economics. Even some Democrats not running for President have said corporations pay too little. Congressman Rahm Emanuel (D-Illinois) noted in an October 15 *Wall Street Journal* op-ed that the "corporate tax burden [in 2002] fell to its lowest level since 1983." Accounting shenanigans, overseas tax shelters, and the Bush tax cuts are regularly blamed.

By the Numbers

The main reason for the drop in revenue from corporate taxes is much less mysterious—and also less interesting to the press or politicians—when viewed over time. Since World War II, the federal government's dependence on corporate income tax revenues has been falling steadily.

According to the Office of Management and Budget, federal tax collections from corporations peaked in 1943, when corporate tax revenue was 39.8 percent of total federal tax collections. In more recent history, corporate tax revenue was as high as 17 percent of total federal tax collections in 1970, bottoming out at just 6 percent in 1983. During the 1990s, corporate tax revenues rose again following President Bill Clinton's 1993 tax increase, which raised

the top statutory corporate income tax rate from 34 percent to 35 percent. Congressman Emanuel's statement is basically correct, but it would be true for almost every year since 1943, too.

Just because the corporate income tax is a smaller share of the federal revenue pie doesn't mean corporate tax collections have fallen in dollar terms. The long-term trend of federal corporate tax receipts is upward, from \$123 billion collected in 1970

"The long-term trend of federal corporate tax receipts is upward, from \$123 billion collected in 1970 to \$136 billion collected in 2000 (both expressed in real dollars)."

to \$136 billion collected in 2000 (both expressed in real dollars). Corporate profits are volatile, rising in boom economies and falling in recessions, and so too are government receipts from the corporate income tax. Federal corporate tax receipts dipped during the current recession as well as those of the early 1980s and early 1990s. Yet corporate tax collections for 2002 (\$142.7 billion in real terms) were still higher than corporate tax collections at any time during the recession of the early 1980s or 1990s.

A corporation's tax burden is measured by how much the firm pays in taxes in relationship to what it makes in profit. That rate has been on a steady downward trend for 30 years. Yet the total effective rate for 2002 is higher than it was in 2001, and also higher than the effective tax rates for the years 1995 through 1997. Corporations have a higher tax burden today than they did at the end of the Clinton administration's tenure.

S Corporations More Popular

Since the most recent peak in 2000, at just over 10 percent, corporate income tax revenue has fallen slightly as a share of total federal tax revenues. Tax shelters are not to blame. A much more interest-

ing and nuanced phenomenon is taking place: Alternative legal arrangements such as S corporations have become increasingly popular.

Between 1986 and 2001, the number of S corporations in the United States more than quadrupled, while the number of all other corporations grew by just 6 percent. In 1999, more corporations filed as S corporations than in all other corporate structure categories.

As S corporations continue to grow in popularity, the share of federal revenue derived from the corporate tax will continue to fall. Income earned through an S corporation is taxed only once, whereas income earned through a C corporation is taxed twice: once through the corporate income tax, and again when investors pay individual income taxes on dividends. As the percentage of business activity conducted through S corporations increases, a larger portion of taxes will be collected through the personal income tax instead of the corporate income tax.

This should serve as a wake-up call for federal and state policymakers. The corporate income tax is one of the most burdensome and economically inefficient taxes in the federal/state tax code. Simplifying, lowering, or eliminating this burdensome tax entirely would remove a very significant source of inefficiency from the capital markets and promote economic growth. That alone would do far more for the future of America than any class-warfare rhetoric.

Stephen Slivinski is a senior economist for the Washington, DC-based Tax Foundation. His email address is slivinski@taxfoundation.org

INTERNET INFO

See Tax Foundation *Special Report* No. 126, "The Corporate Tax Burden," written by Stephen Slivinski and published in November 2003. The 12-page report is available on the Tax Foundation Web site at <http://www.taxfoundation.org/SR126.pdf>.

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Bush

Continued from page 1

- repeal the expanded 10 percent tax rate, which cut taxes for all taxpayers, rich and poor;
- reverse the support for capital purchases by small and medium sized businesses; and
- resuscitate federal death taxes currently scheduled to die a long-deserved death in 2010.

The worst news for the economy would come in 2011, when all of the tax rate reductions disappear and taxpayers are faced with the biggest tax increase in the nation's history.

"Let me be perfectly clear: Failure to make the tax relief permanent would be a huge mistake and would put our recovery in jeopardy," Treasury Secretary John Snow said in a recent appearance at the U.S. Chamber of Commerce.

Political people know tax increases commonly worry taxpayers, who then express their concerns in the next election. While the President did not mention this consideration in his State of the Union address, it doubtless weighs heavily on the minds of most members of Congress.

A more important reason to make the 2001 tax cuts permanent, however, is the harm Congress would cause the economy if it failed to do so. For most Americans, the vitality of the economy trumps nearly every other aspect of life outside the family.

According to the *Boston Globe*, Snow reported the tax cuts had been a "major force lifting the U.S. economy out of a recession and a prolonged period of sluggish growth." Snow said a Treasury Department analysis showed that "without the tax cuts the unemployment rate, currently 5.9 percent, would be a full percentage point higher, and as many as 1.5 million Americans would not now have jobs."

Snow's report and a growing body of evidence strongly suggest the 2001 tax cuts, and additional tax cut legislation since, have significantly boosted short-

"When Congress ... threatens to let a tax cut expire in the distant future, say 2011, investors put their money into projects that will pay out over a shorter amount of time and pull out of long-term investments ..."

term economic growth. "With adoption of the President's policies, our projections show a solid path toward cutting the deficit in half, toward a size that is below 2 percent of GDP, within the next five years," Snow said.

The February 3 budget estimate from the President's Congressional Budget Office has the 2005 federal deficit projected at \$363 billion. Snow's comments point toward much lower deficit figures in ensuing years as the economy moves from recovery into expansion.

What's leading to better growth and lower deficits?

■ Business investment, a key engine of economic activity, expanded in late 2003 at the fastest rate since 1980.

■ The pace of economic activity in the third quarter of 2003 jumped by more than 8 percent, which is the best quarterly increase in the gross domestic product in 20 years.

■ Stock market wealth has increased by more than \$3 trillion this past year, bringing overall market values near their levels during the last economic expansion.

■ Worker productivity in the last half of 2003 grew nearly three times faster

money from the bank. The higher cost of borrowed money means fewer houses are built and businesses are more reluctant to expand their operations. In short, you get less economic growth when capital costs more.

The same economics applies to the taxation of labor and other forms of economic activity: Raising taxes increases the cost of the activity taxed, which generally lowers its use. The pace of economic activity suffers, which ultimately means slower job and income growth.

When Congress lets a tax cut expire, it endangers economic growth. Even when it threatens to let a tax cut expire in the distant future, say 2011, investors put their money into projects that will pay out over a shorter amount of time and pull out of long-term investments, like research that will yield results only after 10 years or a new factory that must be paid off over a 20-year period. In other words, investors often view inaction by Congress to make a tax cut permanent as a signal of higher taxes—and thus prices—in the future. The economic damage is done even as Congress sits on its hands.

The President was right to call for immediately making the temporary tax cuts permanent. If Congress dithers rather than acting, it will directly shape an economic future filled with more joblessness and poverty than there otherwise would be.

William W. Beach is director of the Center for Data Analysis at The Heritage Foundation. He can be reached at staff@heritage.org.

A Timely Reference Book for Tax-Filers

review by Duane Young

If you are genuinely interested in the Internal Revenue Service or expect to be involved in a tax audit, *The IRS Problem Solver* by Daniel J. Pilla will prove to be an excellent resource.

The IRS Problem Solver is a "common-sense book" using chapter categories that fit particular needs. The many useful graphics include sample tax forms and letters to the IRS.

I have communicated many times with the IRS, both personally and professionally. In my experience, oral communication seldom works, except under special circumstances. The author's sample letters are an excellent tool. The only advice I have concerns his specific reference to legal codes and laws both in stating the case and demanding relief. A concise, direct approach to the problem and the remedies sought may be adequate in some cases.

The IRS Problem Solver should be considered a versatile textbook useful for isolating narrow areas of interest. It may even be essential reading for those who file for others. It is one thing having to slog through filling out tax

forms and learning arcane tax law. It is quite another understanding what it is like if you are audited, receive a tax letter, file incorrectly, or do not bother to file. The author's example of a tax filer willing to back his client's claims but incapable of communicating with the IRS could probably have been prevented through use of this book.

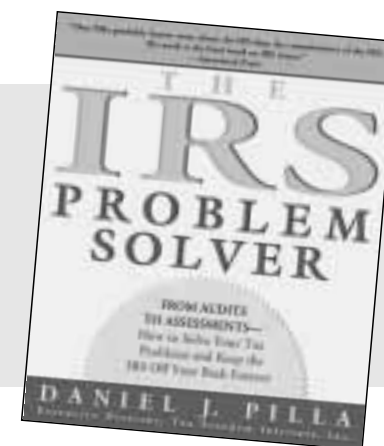
When it comes to finance and taxes, nothing beats "self reliance." Tax professionals are costly, and you are still ultimately responsible for your own well-being. If you can understand this relatively simple exposition about the IRS and its peculiarities, why not file your own taxes? While it may be impossible for small and medium-sized business owners to do their own taxes, there is a chapter in the book devoted to preparing them for IRS scrutiny.

The most useful aspect of the book is its ability to teach what is expected by a particular type of communication from the IRS. It follows a likely progression from what to expect to how to respond. The author's main point is not to be afraid.

The IRS Problem Solver also

The IRS Problem Solver:
From Audits to Assessments—
How to Solve Your Tax Problems and
Keep the IRS Off Your Back Forever

Daniel J. Pilla
Regan Books, 2003
\$15.95, 320 pages, ISBN 0060533455



includes chapters addressing marital and divorce financial problems, handling tax audits, and negotiating with the IRS when a levy is unavoidable. The author offers strategic advice for "insulating" oneself from the IRS. He examines the culture of the IRS as it moves into the twenty-first century.

This makes Daniel J. Pilla's eleventh publication on taxpayers'

rights a timely reference book for any taxpayer's library. It is also, I would guess, why he is probably working on number twelve.

Duane Young recently retired from the American Farm Bureau Federation in Park Ridge, Illinois. He has more than 23 years of experience in business and personal tax matters with AFBF.

Tax Fairness versus Tax Morality

by Craig J. Cantoni

Politicians talk about “tax fairness,” but never about tax *morality*. That’s because their notion of a fair tax is really an immoral tax, for it is based on theft (some people taking money from other people for themselves). Let’s look at examples of moral and immoral taxes and four principles to use in determining which is which.

The first example is gas taxes. The portion of gas taxes that funds roads is a moral tax, because the users of roads pay for the cost of the roads and do not shift the cost to non-users.

On the other hand, the portion of gas taxes that funds mass transit is an immoral tax. It is wrong for mass transit riders to take the money of non-riders instead of paying the full cost of their ride in fares.

If you think this is a minor matter, think again. Someone who takes the typical light-rail system to work everyday over a 25-year career will receive \$100,000 in “subsidies,” which is a euphemism for “stolen money.”

Direct taxes and fees, such as a city water bill based on water usage, are the most moral way of paying for government services, because the users pay directly for the services and cannot stick their neighbor with the bill.

This leads to our first principle of taxation:

Principle One: The most moral way of funding government services is through direct taxes and fees.

Of course, it is not practical to charge citizens directly in taxes or fees for many

government services. In such cases, general taxes are necessary, and the following principle applies:

Principle Two: General taxes are moral if they are taken from all citizens in equal proportions and used to the extent practical for the equal benefit of all citizens.

An example of the above principle is taxes for national defense. Some would argue taxes are immoral if used to fund what they see as an unjust war. They would have a point. But in such a case, it is the war that is immoral, not the taxation. This leads to a third principle:

Principle Three: The morality of taxes should be judged separately from the morality of the use of tax revenues.

Applying this principle in the national defense example, the war may be immoral but the taxes are moral, since they do not take money from some citizens for the benefit of other citizens.

Contrast this with Medicare taxes for prescription drugs. In this case, the taxes are immoral, because they are a form of inter-generational theft. They take money from younger generations for the benefit of the retired generation. However, the use of the tax revenues, buying medicine, is not immoral, for there is nothing wrong with seniors buying medicine.

Similarly, it is moral for citizens to help those in need. Not only that, but a case can be made that it is *immoral* for someone not to feed the hungry and care for the sick. But it is wrong for the government to force some citizens to support other citizens through the tax code. Which brings us to our fourth principle.

Principle Four: Compassion and char-

ity are personal and religious matters, not matters for the tax collector.

When Principles Are Violated

Violating the four principles has resulted in over half of government revenue being taken from some citizens for the benefit of other citizens. Politics has become a gigantic game in which the objective is to have the government take someone else’s money before the other person has the government take your money. Stated differently, over half of government activity is funded by theft. Thus, the power and reach of government and politicians would be cut at least in half if the four principles were followed.

Violating the principles also has resulted in uneconomic decisions, wasted capital, and rising costs. When someone else is picking up the tab, cost is no object to the recipient. It is not a coincidence that the two most socialized areas of the economy, health care and K-12 education, are the most inefficient.

Admittedly, there are gray areas with the principles, as there are with any philosophy of government. In such cases, the best course of action is to discuss why the principles apply or don’t apply, and then to vote on the issue. This is quite different from what happens today, when there is no discussion of guiding principles and voting is based solely on self-interest.

What about Medicare? Is this a gray area? The answer is no. Medicare is immoral, because much of the cost is shifted from users to non-users. It also is immoral because it turns doctors into indentured servants of the state, but that

Principles of Taxation

- The most moral way of funding government services is through direct taxes and fees.
- General taxes are moral if they are taken from all citizens in equal proportions and used to the extent practical for the equal benefit of all citizens.
- The morality of taxes should be judged separately from the morality of the use of the taxes.
- Compassion and charity are personal and religious matters, not matters for the tax collector.

is another subject for another day.

For Medicare to be a moral program in terms of taxation, the payroll taxes paid by individuals over a lifetime would fund the benefits received by them in retirement. Medicare would be a true insurance program and operate similar to life insurance, in the sense that payroll taxes, or premiums, would buy a defined benefit. And, as is the case with life insurance, grandparents would not send their Medicare premiums to their grandchildren or strangers.

What if premiums paid did not end up covering 100 percent of future medical expenses? The difference would be paid out-of-pocket, or in the case of the poor, covered by private charity.

Such a program would be both fair and moral, which is why politicians who believe in state plunder won’t embrace it.

Craig J. Cantoni is an author, columnist, and founder of Honest Americans Against Legal Theft (HAALT). His email address is ccan2@aol.com.

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